

*United States Court of Appeals
for the District of Columbia*

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James W. Starnes

CLERK

No. 8995

United States Court of Appeals
DISTRICT OF COLUMBIA

329

UNITED STATES OF AMERICA, APPELLANT

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
AND JAMES H. FLANAGAN, JAMES F. REILLY, AND CHARLES
W. KUTZ, CONSTITUTING THE PUBLIC UTILITIES COMMISSION
OF THE DISTRICT OF COLUMBIA, RESPONDENTS

and

JAMES LAUDERDALE, PEOPLE'S COUNSEL

and

POTOMAC ELECTRIC POWER COMPANY, INTERVENORS

APPELLANT'S APPENDIX, VOL. I

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PUBLIC UTILITIES COMMISSION OF THE
DISTRICT OF COLUMBIA

July 22, 1944

Findings and Opinion

P. U. C. No. 3362

Formal Case No. 335

P. U. C. No. 3377

Formal Case No. 338

IN THE MATTERS OF

POTOMAC ELECTRIC POWER COMPANY

Sliding-Scale Arrangement and Investigation of Rates, Tolls,
Charges, Rules, Regulations, and Conditions of Service

NATURE OF PROCEEDING

On April 26, 1943, by its Order No. 2565, this Commission ordered that an investigation be made to determine, with respect to the electric service furnished by Potomac Electric Power Company (hereinafter referred to as "Pepco" or "the Company"):

1. Whether the sliding-scale method of electric rate regulation shall be abandoned.

2. Whether the sliding-scale method of electric rate regulation shall be continued in its present form or with modifications of the basic elements of the existing arrangement.

3. Without limiting the scope of the investigation, what modifications, if any, shall be made in the following basic elements of the present sliding-scale arrangement:

- (a) The rate base.
- (b) Rate of return.
- (c) Depreciation accruals.
- (d) Method of effecting rate reductions.

On January 5, 1944, by its Order No. 2703, this Commission ordered that an investigation be made relative to rates, tolls.

charges, rules, regulations, and conditions of service of Pepco, pursuant to the provisions of the sliding-scale arrangement as now constituted or as it may be modified as a result of the investigation authorized by Order No. 2565.

On January 26, 1944, the Commission issued its Notice of Hearing in which it stated that the matters set forth in Orders Nos. 2565 and 2703 would be consolidated and set down for formal public hearing to be held on February 28, 1944.

The United States of America, through two of its agencies, namely, the Treasury Department, by its Director of Procurement, and the Public Buildings Administration of the Federal Works Agency, and the Federation of Citizens' Associations, through its Public Utility Committee, were permitted to intervene.

Formal public hearings were held on 33 days in the period from February 28, 1944, to May 9, 1944, inclusive. Briefs were filed by the various parties on May 31, 1944.

THE SLIDING-SCALE ARRANGEMENT

A. Authority for a Sliding-Scale Arrangement

The Commission is authorized to adopt the sliding-scale method of rate determination by the provisions of Paragraph 18 of the Act of March 4, 1913 creating the Public Utilities Commission. The provisions of this paragraph are given below:

"Par. 18. That nothing in this section shall be taken to prohibit a public utility, with the consent of the commission, from providing a sliding scale of rates and dividends according to what is commonly known as the Boston sliding scale, or other financial device that may be practicable and advantageous to the parties interested. No such arrangement or device shall be lawful until it shall be found by the commission, after investigation, to be reasonable and just and not inconsistent with the purposes of this section. Such arrangement shall be under the supervision and regulation of the commission. The commission shall ascertain, determine, and order such rates, charges, and regulations, and the duration thereof, as may be necessary to give effect to such arrangement, but the right and power to make such other and further changes in rates, charges, and regulations as the commission may ascertain and determine to be necessary and reasonable, and the right to alter or amend all orders relative thereto, is reserved and vested in the commission notwithstanding any such arrangement and mutual agreement."

B. Adoption of the Arrangement

On May 2, 1917, this Commission had issued its Order No. 208, in which it found the fair value of the property of Pepco used and useful for the convenience of the public within the District of Columbia as of December 31, 1916.

Following this finding, the Commission, on July 13, 1917, issued its Order No. 223, in which it established rates for service predicated upon a rate of return of 7% upon the fair value of the property of Pepco established by Order No. 208. Pepco did not accept the determinations made by the Commission, and protracted litigation followed.

On December 31, 1924, 7½ years after the determination made by the Commission of the fair value of the property of Pepco and the rates to be charged for service, the Supreme Court of the District of Columbia (now the United States District Court for the District of Columbia) issued a decree (commonly known as the "consent decree") which terminated the litigation involving these matters.

The aforementioned consent decree recited that on December 20, 1924, counsel announced that the parties were able to reach an agreement settling all matters in controversy, bringing the valuation of Pepco's property down to that time, and also establishing a sliding scale as a basis upon which rates should be made in the future.

After reviewing the provisions of the sliding-scale arrangement and other matters pertinent to the proceedings, the Court ordered that on or before January 2, 1925, Pepco file new schedules and rates to be charged the public for electric service furnished within the District of Columbia, which rates should continue to be the lawful rates until modified or set aside by future orders of this Commission, pursuant to law and in accordance with the agreement heretofore mentioned.

Thus was the sliding-scale arrangement promulgated.

C. Basic Elements of the Arrangement

The basic elements of the arrangement as contained in the aforementioned consent decree, insofar as they pertain to the

establishment of rates for electric service, may be summarized as follows:

1. The Commission was to determine the fair value of property used and useful as of January 1, 1925, including Maryland property, at \$32,500,000.

2. The depreciation reserve as of December 31, 1924, was set at approximately \$4,000,000 with the provision that interest on the reserve be accrued on a 4% basis as an accretion to the reserve, thus lessening the amount of depreciation to be included as an expense of operation. A formula was established for the calculation of rates of depreciation under which, when the depreciation reserve is below 15% of the rate base, the rate of depreciation to be used is 2.3%; as the depreciation reserve approaches 20% of the rate base, the rate of depreciation is reduced by .2% for each increase of 1% in the ratio until a 20% ratio is reached; and thereafter the accretions to depreciation reserve are to be such as not to create a reserve in excess of 20% of the rate base.

3. Rates for 1925 were to be based upon a return of 7½% on the fair value of \$32,500,000, plus estimated cost of additions undepreciated and weighted.

4. Provision was made for reduction of rates in the event the return was in excess of the basic rate of return, in the following terms:

"If the rates hereafter yield more than a 7½% return on \$32,500,000, plus actual cost of future additions undepreciated but weighted during a period of any one year, one-half of said excess shall be used in a reduction of rates to be charged the public for electric service thereafter, thereby providing a sliding scale of rates under the provisions of Paragraph 18 of the Act creating the Public Utilities Commission, advantageous to the public and the Company alike; that is to say, by way of example, if the return for any one year should amount to \$100,000 over and above 7½% on the base ascertained as aforesaid, then the rates for the succeeding year to be charged the public shall be automatically reduced by the filing of new rate schedules to absorb \$50,000 of such excess during such year."

5. Provision was made for increase of rates in the event the return fell below the basic rate of return, in the following terms:

"If the average return for any consecutive 5-year period falls below 7½% on the base ascertained as aforesaid, or if the average rate for any consecutive 3-year period falls below 7% on the base ascertained as aforesaid, or if the return for any consecutive 12-month period falls below 6½% on the base ascertained as aforesaid, the Commission shall promptly increase rates so as to yield 7½% on the base ascertained as aforesaid."

The basic rate of return has been modified from time to time, after due notice of investigation and hearing. The basic rate of 7½% prevailed from January 1, 1925 to June 8, 1931, at which date it was reduced to 7%. In 1935 it was further reduced to 6½%, which rate prevailed until 1937, when it was reduced to the present rate of 6%.

Reductions in the basic rate of return have, of course, necessitated modifications in the formula governing rate decreases or rate increases under the arrangement. The provisions governing such matters presently in effect are quoted below:

"If the rates hereafter yield more than 6% in any calendar year (hereinafter referred to as the test year), on the rate base for that year the excess over and above the said 6% shall be used in a reduction of rates to be charged the public for electric service, beginning March 1 of the following year, as follows:

"If the amount earned is more than 6% and not more than 7¼% of the rate base, rates for the 12 months following March 1 based on the business done during the test year shall be so adjusted (by use of the formula stated below) that the gross receipts of the Company during the year next following the test year shall be reduced by 50% of such excess; if the amount of return is in excess of 7¼% and not more than 8%, an additional amount of 60% of the said excess over 7¼% shall be used for the reduction of rates; if the amount earned is in excess of 8%, a further additional amount of 75% of the excess over 8% shall be used in like manner for the reduction of rates.

"Formula for rate reduction: From the portion of the excess which is available for rate reduction shall be deducted the difference in the revenue from the kwh sold in January and February of the test year at the rates in effect during those months and the same kwh at the rates in effect during the balance of the test year. The resulting amount will be absorbed by new rate schedules so devised as to effect a reduction in gross income of that amount from March 1 to December 31 of the year following the test year, based upon the test year kwh March 1 to December 31.

"If the rate of return for any 2 consecutive years falls below 5¾% of the rate base for each of 2 said years, or if the rate of return for any consecutive 12-month period falls below 5½% of the rate base for the same period, the Commission shall promptly increase rates, in a manner similar to that prescribed above for a reduction of rates, so as to yield as nearly as may be 6% upon the rate base as of the date of the order effecting such changes in rates."

D. History of Operations under the Arrangement

1. RATE REDUCTIONS

During the year 1924, the rates for residential service charged by Pepco were well above the national average.¹ For example, the cost of 100 kwh consumption for residential service in the District of Columbia was \$9.24 in 1924, as compared with an average cost of \$6.18 for comparable consumption in 150 cities having a population of 50,000 or more. The consent decree previously referred to contained a provision for the distribution of the funds which had been impounded under the terms of a previous court order, which funds represented the difference between the rates actually collected and those which were prescribed by Commission Order No. 223, dated July 13, 1917. As a result of this provision, \$2,944,222.77 was refundable to ratepayers who contributed to these impounded

¹ Exhibit No. 3, Schedule 9.

funds through the rates paid by them between August 1, 1917 and December 31, 1924.

As a result of the new rate schedules ordered into effect as of January 1, 1925, the difference between the cost of Pepco's service and the national average cost was substantially reduced. However, the cost for 100 kwh consumption for residential service in the District of Columbia in the year 1925 was \$7.02, while the average cost for 150 cities having a population of 50,000 or more was \$6.00.

Annual rate reductions followed the promulgation of the sliding-scale arrangement. As a result thereof, Pepco's rates immediately assumed a more favorable comparable aspect. Again using 100 kwh consumption for comparative purposes, the cost of such residential service in the District of Columbia fell below the national average cost during the year 1930 and remained consistently and progressively lower in each of the succeeding years. For the year 1942, the cost for 100 kwh consumption for residential service in the District of Columbia was \$2.56, as compared with an average cost of \$3.80 for all cities having a population of 50,000 or more.

The aggregate rate reductions put into effect during the years 1926 to 1943, inclusive, on a non-cumulative basis, are reflected in the following tabulation:

1926	-----	\$ 352,164
1927	-----	430,829
1928	-----	337,895
1929	-----	624,062
1930	-----	660,035
1931	-----	830,463
1932	-----	861,023
1933	-----	563,335
1934	-----	379,841
1935	-----	148,921
1936	-----	310,755
1937	-----	504,682
1938	-----	770,080
1939	-----	393,986
1940	-----	575,297
1941	-----	338,324
1942	-----	-----
1943	-----	311,784
		\$8,393,476

2. RETURN TO PEPCO

While under the provisions of the sliding-scale arrangement the basic rate of return originally approved was $7\frac{1}{2}\%$, this basic rate of return was subsequently reduced as shown below:

1931 to 7%
 1935 to $6\frac{1}{2}\%$
 1937 to 6%

It is significant to note that with the passage of the years the actual return earned by Pepco more closely approximated the basic rate of return established. Thus, during the years 1925 to 1930, inclusive, when the basic rate of return allowed was $7\frac{1}{2}\%$, the average rate of return actually earned over this period was 10.03% per annum; during the years 1931 to 1934, inclusive, during which period the basic rate of return allowed was 7%, the actual average rate of return was 8.46%; during the 2 years 1935 and 1936, when the basic rate of return was $6\frac{1}{2}\%$, the actual return was 7.42% and 7.91% for each of these respective years. From 1937 to 1942, inclusive, during which period the basic rate of return established was 6%, the actual return earned ranged from 7.95%, down to 5.99% or an average of 6.91%. To summarize, the difference between the highest basic rate of return and the average return during the period in which it was effective was slightly more than $2\frac{1}{2}\%$, whereas during the period when the 6% basic rate of return was effective, the actual return, on the average, was but .91 of 1% in excess thereof.

The sliding-scale arrangement, as previously explained, provides that Pepco shall retain all earnings, but a portion of the excess of such earnings over the basic rate of return allowed is used as the measure of rate reductions in ensuing years. The record of the earnings available for rate adjustments, with pertinent rates of return; the amount allowable as return before calculating such rate adjustments; and the amount of earnings in excess of those determined at the basic rate of return are reflected in the following tabulation:

<i>Year</i>	<i>Net Amount Available For Return</i>	<i>Actual Rate of Return</i>	<i>Basic Rate of Return</i>	<i>Return Calculated At Basic Rate</i>	<i>Excess Earnings</i>
1925	\$ 3,223,391.13	9.59%	7.50%	\$ 2,520,614.21	\$ 702,776.92
1926	3,510,466.94	9.72%	7.50%	2,709,879.26	800,587.68
1927	3,750,996.85	9.22%	7.50%	3,052,496.39	698,500.46
1928	4,512,974.66	10.28%	7.50%	3,291,984.17	1,220,990.49
1929	4,958,654.63	10.34%	7.50%	3,597,817.34	1,360,837.29
1930	5,286,591.86	10.71%	7.50%	3,702,967.81	1,583,624.05
1931	5,268,275.60	9.56%	7.00%	3,858,793.40	1,409,482.20
1932	5,170,304.13	8.80%	7.00%	4,110,962.22	1,059,341.91
1933	5,080,999.27	8.23%	7.00%	4,323,161.37	757,837.90
1934	4,920,123.90	7.45%	7.00%	4,625,122.75	295,001.15
1935	5,002,212.66	7.42%	6.50%	4,381,490.99	620,721.67
1936	5,545,009.41	7.91%	6.50%	4,558,856.88	986,152.53
1937	5,864,029.02	7.95%	6.00%	4,427,570.50	1,436,458.52
1938	5,420,107.07	7.02%	6.00%	4,631,936.35	788,170.72
1939	5,985,565.31	7.39%	6.00%	4,858,485.52	1,127,079.79
1940	5,772,730.71	6.79%	6.00%	5,098,722.08	674,008.63
1941	5,692,076.06	5.99%	6.00%	5,704,082.07	(12,006.01)
1942	6,630,073.44	6.62%	6.00%	6,009,253.85	620,819.59
	<u>\$91,594,582.65</u>			<u>\$75,464,197.16</u>	<u>\$16,130,385.49</u>

As has been pointed out, the rate reductions put into effect in each year succeeding that in which there were excess earnings aggregated \$8,393,476. The record shows that, as each year's reduction has been continued in effect throughout the ensuing years, the cumulative savings to the ratepayers (without giving consideration to additional savings applicable to increased consumption in each of the 18 years) have amounted to more than \$86,000,000.

The favorable earnings record portrayed above has enabled Pepco to establish and maintain an enviable credit standing and to purchase modern equipment which resulted in greater efficiency and a lowering of unit cost. It further permitted the financing of plant additions, betterments, and extensions to a substantial degree from earnings retained in the business. In addition, Pepco has been in a position to declare and pay very substantial dividends on its common stock. The common-stock equity (weighted) for each year; the income available for common stock; and the common-stock dividends, together

with pertinent percentages as to earnings and dividends on common-stock equity, are reflected in the following tabulation:

Year	Common- Stock Equity (Weighted)	Income Available for Common Stock	Common- Stock Dividends	% of Earn- ings on Com- Stock Equity	% of Divs. on Com- Stock Equity
1925 ----	\$ 8,126,886.45	\$ 2,598,289.50	\$ 840,000.00	31.97	10.34
1926 ----	10,042,743.09	2,799,940.62	960,000.00	27.88	9.56
1927 ----	11,955,192.05	2,980,336.59	1,080,000.00	24.93	9.03
1928 ----	13,967,351.40	3,506,743.91	1,200,000.00	25.11	8.59
1929 ----	16,482,101.06	3,899,687.56	1,320,000.00	23.66	8.01
1930 ----	19,810,829.98	4,372,013.70	1,440,000.00	22.07	7.27
1931 ----	23,344,058.65	4,202,255.29	1,560,000.00	18.00	6.68
1932 ----	25,951,080.26	4,109,602.51	1,680,000.00	15.80	6.47
1933 ----	28,375,603.29	3,996,359.64	1,800,000.00	14.08	6.34
1934 ----	30,557,743.97	3,637,784.07	2,280,000.00	11.90	7.46
1935 ----	31,900,139.28	3,630,460.99	2,550,000.00	11.38	7.99
1936 ----	33,235,529.37	4,093,619.98	3,600,000.00	12.32	10.83
1937 ----	33,943,624.84	4,508,267.78	3,900,000.00	13.28	11.49
1938 ----	34,520,977.37	3,710,454.28	3,900,000.00	10.75	11.30
1939 ----	34,334,538.55	3,851,566.32	3,900,000.00	11.22	11.36
1940 ----	34,288,544.67	3,575,306.01	3,540,000.00	10.43	10.32
1941 ----	34,369,830.96	3,560,007.46	3,540,000.00	10.36	10.30
1942 ----	35,914,645.60	3,551,074.81	3,105,000.00	9.89	8.65
		<u>\$66,574,771.02</u>	<u>\$42,195,000.00</u>	<u>14.44</u>	<u>9.15</u>

E. *Conclusions as to Sliding-Scale Method of Rate Determination*

As previously stated, the present proceedings involve, inter alia, the determination whether (1) the sliding-scale method of rate regulation shall be abandoned or (2) the sliding-scale method of rate regulation shall be continued in its present form or with modification of the basic elements of the existing arrangement.

The United States intervened in the proceedings through two separate agencies, each of which took contrary positions upon the question of the retention or the abandonment of the sliding-scale method of rate regulation.

Counsel for the Procurement Division of the Treasury Department, throughout the hearings and in their brief filed on

June 7, 1944, have not urged the abandonment of the sliding-scale method of rate determination, but have argued that substantial modifications of the arrangement as presently constituted are necessary. They offered evidence in support of their proposed modifications, which will be discussed hereinafter.

On the other hand, counsel for the Public Buildings Administration alleged in their petition of intervention that the sliding-scale plan should be abandoned, on the ground that the plan is not in the public interest and results in a serious injustice to the consumers of electric energy; that it is based upon a wholly unrealistic valuation basis, complemented by an unsound depreciation policy, and results in an excessive return to the Company.

Counsel for this agency did not call a witness to substantiate any of the allegations made. The only witness called by them was in support of a prudent-investment rate base. That witness approved the sliding-scale principle in the method of annual rate adjustments, the accounting method of determining rate base, and, contrary to the allegation that the depreciation allowance under the sliding-scale plan is excessive, testified that the Company had not been permitted under the sliding-scale plan to accrue sufficient annual depreciation charges or to accrue an adequate depreciation reserve.

Counsel for the Federation of Citizens' Associations of the District of Columbia strongly recommended that the sliding-scale principle be retained, with such modifications as, in the opinion of this Commission, appear to be necessary.

Counsel for Pepco have consistently stated that the Company is willing to abide by the sliding-scale arrangement as presently constituted and have clearly indicated that if any of the provisions of the present sliding-scale plan are modified by this Commission in such a way as to make the plan unacceptable to Pepco, the Company may withdraw from the plan, since, in its opinion, it would no longer be a "plan provided by the utility" or an arrangement evidencing a "mutual agreement" between the Company and this Commission, which, in

the opinion of counsel for Pepco, are the statutory prerequisites to a sliding-scale plan.

After a careful review of the record and upon serious consideration of all the factors involved in respect of the question whether the sliding-scale method of rate determination should be abandoned or modified, this Commission has arrived at the following conclusions:

1. The sliding-scale principle of electric rate determination is advantageous to the public and to the utility, and it should be preserved.
2. The sliding-scale arrangement as presently constituted, in the light of existing conditions, requires substantial modification.

In subsequent portions of these findings, the modifications deemed by the Commission to be necessary in the public interest will be discussed in detail.

The principal reasons which prompt this Commission to consider it desirable to retain the sliding-scale principle of rate determination with respect to the operations of Pepco are as follows:

1. The detailed annual inspection of the accounts of the utility required by this method is conducive to meticulous care in accounting practices of the Company and to a continued intimate knowledge by the Commission of the operations of the utility.
2. The rate base is under constant supervision and is kept current through the need for a basis for annual redetermination of rates.
3. The annual determination of rates through the application of a formula which is subject to review in the light of changing conditions is economical, expeditious, and far superior to the practice of determining rates at infrequent periods, the need for which must become apparent only after extensive investigations, or on complaints from ratepayers.
4. The incentive provision inherent in the use of a basic rate of return enables the utility to enjoy limited profits in excess of the basic return, thereby encouraging the practice of operating and financial economics.
5. An arrangement predicated upon this principle tends to minimize controversies which are costly, time-consuming, injurious to the good will of the utility, and contrary to the best interests of the consuming public.

THE RATE BASE

A. Development under the Sliding-Scale Arrangement

The rate base employed under the provisions of the existing sliding-scale arrangement has been developed in the following manner:

To the initial rate base of \$32,500,000 determined as of January 1, 1925, there has been added the actual cost of subsequent net additions, undepreciated, after deducting the cost of property paid for by contributions in aid of construction and by deposits for extensions. The following tabulation shows the development of the unweighted rate base for each of the years 1925 to 1942, inclusive:

Year	Rate Base at Beginning of Year Excluding Working Capital	(1) Net Additions during Year	(2) Working Capital (Cash and Materials and Supplies)	Rate Base at End of Year
1925	\$31,610,254.85	\$2,068,743.51	\$1,000,427.65	\$34,679,426.01
1926	33,678,998.36	2,863,320.60	1,159,659.29	37,701,978.25
1927	36,542,318.96	4,723,505.76	1,329,800.29	42,595,625.01
1928	41,265,824.72	2,816,233.57	1,304,531.06	45,386,589.35
1929	44,082,058.29	4,400,920.94	1,406,932.80	49,889,912.03
1930	48,482,979.23	1,596,289.22	1,362,713.20	51,441,981.65
1931	50,079,268.45	6,338,607.89	1,404,066.24	57,821,942.58
1932	56,417,876.34	1,817,500.27	1,436,249.41	59,671,626.02
1933	58,235,376.61	5,107,931.47	1,609,935.79	64,953,243.87
1934	63,343,308.08	2,336,244.79	1,864,136.27	67,543,689.14
1935	65,679,552.87	1,344,154.17	1,874,808.42	68,898,515.46
1936	67,023,707.04	2,778,534.34	1,734,764.33	71,537,005.71
1937	69,802,241.38	3,752,013.13	2,177,083.76	75,731,338.27
1938	73,554,254.51	3,923,170.51	2,094,021.67	79,571,446.69
1939	77,477,425.02	2,925,564.61	2,124,948.23	82,527,937.86
1940	80,402,989.63	8,614,707.04	2,520,974.97	91,538,671.64
1941	89,017,696.67	6,424,211.25	3,234,250.04	98,676,157.96
1942	95,441,907.92	3,660,476.55	3,774,109.25	102,876,493.72

(1) Net additions during the year reflect deductions for the cost of property paid for by contributions in aid of construction and deposits to cover extension of distribution lines. When refunds of deposits exceed new deposits received during any given year the net decrease in the deposit account is added to the rate base.

(2) The allowance for cash working capital consists of one-eighth of operating expenses after deducting depreciation, taxes, and uncollectible bills. The allowance for material and supplies for the years 1925 to 1933, inclusive, consisted of the balance in the material and supplies account at the end of year. For the years 1934 to 1943, inclusive, the allowance has been the average of the monthly balances in the material and supplies account.

For the purpose of calculating annual rate adjustments, the net additions to the rate base in each year have been weighted to reflect the actual number of months in service. A detailed development of the rate base for the 12 months ended December 31, 1943, on an unweighted and a weighted basis, in accordance with the provisions of the existing sliding-scale arrangement, and before any modification thereof, is reflected in the following tabulation:

	<i>Unweighted</i>	<i>Weighted</i>
<i>Rate Base at 12/31/42 (Order No. 2564)—</i>		
<i>Unweighted</i>	\$102,876,493.72	\$102,876,493.72
Less: Working Capital allowance for 12 months ended 12/31/42, included above:		
Cash working capital	(1,158,466.96)	(1,158,466.96)
Materials and supplies	(2,615,642.29)	(2,615,642.29)
<i>Rate Base at 12/31/42, excluding Working Capital</i>	\$ 99,102,384.47	\$ 99,102,384.47
<i>Adjustment as of January 1, 1943</i>		
Adjustment for effect of Reclassification on Rate Base Property	(255.53)	(255.53)
<i>Adjusted Rate Base at 1/1/43</i>	\$ 99,102,128.94	\$ 99,102,128.94
<i>Changes in Rate Base—1/1 to 12/31/43:</i>		
Net Additions to Electric Plant	6,499,960.39	2,698,677.99
Deduct increase in Contributions in Aid of Construction	(118,917.09)	(56,235.43)
Deduct increase in Customers' Deposits for Extensions	(197.74)	417.15
Adjustment of 1943 retirements of 1924 property to 1924 Rate Base values, including minor adjustments applicable to prior years' retirements	(110,016.65)	(51,488.36)
Working Capital allowance for 12 months ended 12/31/43:		
Cash working capital	1,322,111.41	1,322,111.41
Materials and supplies	2,562,581.28	2,562,581.28
<i>Rate Base for 12 months ended 12/31/43</i>	\$109,257,650.54	\$105,578,192.98

The rate base as thus established, on an unweighted basis, is \$5,581,713.76 in excess of the original cost of the property included therein. A brief explanation of this factor follows.

Upon the completion of the study of original cost of Pepco's property, which study pertained to the property in existence as at December 31, 1936 and was completed during the year 1941,² and after recording on the books of Pepco necessary reclassification adjustments ordered and approved by this Commission and the Federal Power Commission (in the net amount of \$2,591,329.70), it was ascertained that the original rate base of \$32,500,000 was \$9,302,806.56 in excess of the book cost of the property included in the original consent decree valuation.

² See Public Utilities Commission Order No. 2138, dated December 31, 1941.

Prior to the original cost determination, this Commission had determined that retirements from the rate base of property in existence on or before December 31, 1924 were not being recorded in such amounts as would eliminate the differential between book cost and consent decree value applicable to such property retired. Accordingly, following public hearings held in 1936, the Commission, by its Order No. 1476 dated February 5, 1936, ordered that the sum of \$1,932,649.37, representing a part of the deficiency in retirements made between January 1, 1925 and December 31, 1935, inclusive, be not included in the rate base. The method of determining the deficiency in the retirement of 1924 property from the rate base, employed in the above-mentioned proceeding, was the basis used for adjusting retirements of such property in each year from 1936 to 1941, inclusive. During this period, an additional amount of \$59,378.61 was eliminated from the rate base as representing the excess of consent decree value over book cost of property in existence December 31, 1924.

In Formal Case No. 326 (see Public Utilities Commission Order No. 2564, issued April 26, 1943), this Commission determined that further revision should be made in the method of retiring 1924 property from the rate base, so that when all the property covered by the consent decree value is retired the entire value representing such property will likewise be removed from the rate base. Pursuant to this determination, an additional amount of \$1,340,423.81 was eliminated from the rate base in order to adjust for retirements of 1924 property made during the years 1925 to 1941, inclusive. Adjustments made during the year 1942 resulted in the exclusion of an amount of \$278,624.36 from the rate base.

Following the procedure established in 1935, as modified by Order No. 2564, the unweighted rate base has been still further reduced in the present proceeding by the amount of \$110,016.65, again representing that portion of the excess over book cost of consent decree value which pertains to 1924 property retired during the year 1943.

Thus, of the original amount of excess of consent decree

rate-base value over book cost of property valued as at December 31, 1924, or \$9,302,806.56, there has been eliminated the aggregate amount of \$3,721,092.80, leaving a balance of \$5,581,713.76 still in the rate base as of December 31, 1943.

B. Position of Parties

The contentions of the various parties appearing before this Commission in the present proceedings, with respect to the rate base, are set forth below.

Counsel for the Procurement Division of the Treasury Department suggest the consideration of all the factors, including "historical cost, depreciated original cost, depreciated both with appropriate deduction of contributions in aid of construction and deposits for extensions and with appropriate allowance for materials and supplies, cash working capital not being required, and prudent investment," and propose that the rate base of Pepco be determined at not in excess of \$67,000,000.

Considering historical cost, counsel would eliminate the excess of the consent decree value over original cost from the rate base. Further, they would increase the depreciation reserve by the amount of approximately \$14,000,000, such increase to represent, in their opinion, earnings from the depreciation fund which should be treated as accretions of the fund.³ On these bases, the net weighted original cost of Pepco's property as at December 31, 1943 is considered by counsel for the Procurement Division to be not in excess of \$67,000,000.

Counsel for the Procurement Division of the Treasury Department contend that the prudent investment in the Company is about \$53,563,000, representing the invested capital after the elimination of the earned surplus and the elimination of \$3,755,000 from the common capital stock account.

The elimination of earned surplus or undistributed earnings from invested capital finds no support in reason or in law. On the contrary, it is universally recognized by both courts and

³ The basis upon which this contention was made was rejected by the Supreme Court in *Vinson v. Washington Gas Light Company*, 321 U. S. 489. The record shows that Pepco has no "depreciation fund."

regulatory authorities that undistributed earnings invested in the assets of a corporation are just as much a part of invested capital as are the dollars obtained by the sale of securities. All adjustments to the common stock account found necessary by the original cost determination previously referred to have been made by charges against earned surplus, in accordance with accepted accounting practice. Hence, the elimination of \$3,755,000 from the common-stock capital of Pepco, as suggested by counsel, would result in a duplicate elimination from the invested-equity capital. The Commission rejects as wholly unsound these contentions.

Counsel for the Public Buildings Administration suggest the adoption by this Commission of a prudent-investment plan of rate regulation. Salient features of their contentions with respect to the rate base involve its determination upon the actual legitimate cost of the electric utility property used and useful in serving the consumers of the District of Columbia; the depreciation of such rate base according to the straight-line method of depreciation; the inclusion in the rate base of a reasonable amount for working capital adjusted to exclude materials and supplies held for new construction; and the exclusion from the rate base of an amount of property equal to Pepco's earned surplus.

Based upon the foregoing principles, they suggest that the rate base (depreciated) should not exceed \$53,659,000, which amount is arrived at in the following manner:

Gross Investment in Plant	\$99,120,000
Less—	
Accrued Depreciation	\$17,071,000
Contributions in Aid of Construction ..	2,482,000
Earned Surplus	28,470,000
	<u>48,023,000</u>
	\$51,097,000
Add—Working Capital	2,562,000
	<u>\$53,659,000</u>
Total	

In arriving at the amount of accrued depreciation to be deducted from the rate base, counsel for the Public Buildings

Administration employ a figure of \$23,903,572 (Exhibit No. 31), which amount was arrived at by the arbitrary use of a formula whose infirmities were clearly explained by C. W. Smith, Chief of the Bureau of Finance, Accounts, and Rates of the Federal Power Commission, a witness who testified for this Commission with respect to such formula and who promptly advocated that a reserve of such amount be not used. From this amount counsel for the Public Buildings Administration deduct approximately \$6,832,000, representing that portion of the reserve which, in their opinion, but without supporting evidence, is applicable to assets represented by the earned surplus of over \$29,000,000, and compute the accrued depreciation to be applied to the proposed prudent investment rate base at about \$17,071,000.

What has been said with respect to the exclusion of undistributed earnings from invested capital applies with equal force here.

This Commission rejects the contentions of counsel for the Public Buildings Administration on the grounds that their adoption would be unsound, without merit, inequitable, and at complete variance with established law.

Pepco has consistently maintained the position that the sliding-scale arrangement as presently constituted is fair to both consumers and the Company and that no change therein should be made. The principal witness for Pepco on the matter of the rate base, Mr. William V. Burnell, Vice-President of Stone & Webster Engineering Corporation, presented testimony purporting to show the problem which will be presented to the Commission in the event the present sliding-scale rate base arrangement is abandoned. Using as the basis of his testimony projected historical cost trends, Mr. Burnell contended that the present fair value of the property used and useful in furnishing electric service, including working capital, is \$117,396,000. Mr. Burnell did not claim that this amount should be substituted for the present rate base, nor has Pepco contended for such a valuation.

In other words, it appears that Pepco takes the position that if the sliding-scale arrangement is abandoned, the Commission

will be faced with the task of fixing a rate base in accordance with the doctrine of *Smythe v. Ames*, which had prevailed for many years, and which usually resulted in the establishment of a rate base predicated largely upon reproduction cost estimates. The Commission cannot agree with this premise. If it were the intention to abandon the sliding-scale arrangement, the problems facing the Commission would differ but slightly from those presently presented. Certainly, there is no requirement in our statute that exclusive consideration be given to reproduction cost in the determination of a rate base.

However, as already indicated, it is not the intention of the Commission to abandon the sliding-scale arrangement, but to effect certain modifications which are plainly indicated to be necessary and desirable.

It is the opinion of this Commission, and it appears that counsel for Pepco are in full agreement with our view,⁴ that under the provisions of Paragraph 18 of the Act creating the Public Utilities Commission, the Commission may at any time (after proper notice) order such changes in the sliding-scale arrangement as it may ascertain and determine to be necessary and reasonable.

Therefore, the Commission deems its primary duty under the statute to be the establishment of a rate base that is fair and reasonable, to the end that rates for service to be based thereon will also be just and reasonable to the consumers and to Pepco alike.

C. *Commission Finding as to Rate Base*

It is the opinion of the Commission that the rate base originally determined and approved by the court was established in conformity with accepted regulatory practice prevailing at that time. The subsequent annual determinations of the rate base by the inclusion of net additions at cost, as required by the provisions of the sliding-scale arrangement, permitted escape from the uncertainties and infirmities of the "fair value" doctrine of *Smythe v. Ames*. Further, this method

⁴ See Pepco brief, page 5.

of rate base determination has resulted in the development of a rate base which is now approximately 95% original cost.

The problem which now confronts the Commission is whether the sliding-scale rate base should be perpetuated, or whether the remaining differential of \$5,581,713.76 between that base and the original cost of property should be eliminated, with the result that the rate base would include only true original cost.

A rate base predicated upon original cost is fair to the utility, its investors, and consumers, because it gives recognition to every dollar actually invested in the property.

Since the use of the cost-of-capital theory in the determination of the rate of return (as discussed hereinafter) requires the application of such cost to a rate base comprising only the capital actually invested, it is obvious that the continued use of the present sliding-scale rate base would require a compensating adjustment in the rate of return.

In the light of the foregoing, and after considering all the evidence, the Commission finds that the electric plant component of the gross rate base shall be the original cost of property used and useful in public service as at December 31, 1943, or \$102,434,682.29 (unweighted), and \$98,633,399.89 (weighted), and that the sliding-scale arrangement shall be modified accordingly.

In addition to the electric plant component of the rate base, the Commission has considered the evidence relating to an allowance for working capital.

It has been the practice under the sliding-scale arrangement to include the average of the monthly balances in the materials and supplies account as a component of the rate base. This treatment is generally in accord with regulatory practice, and the record does not disclose any reason for a change in the method of determining the amount to be allowed. The average of the monthly balances for the year 1943 amounts to \$2,562,581.28, and while this amount is somewhat high in comparison with prior years in relation to the rate base and operating expenses, we recognize the abnormal conditions

which now prevail and find that the foregoing amount is a reasonable allowance.

The allowance for cash working capital under the sliding-scale arrangement has been one-eighth of operating expenses exclusive of accruals for taxes, depreciation, and uncollectible bills. This was predicated upon the allowance made for cash working capital in the Commission's original valuation of the Potomac Electric Power Company in 1917. In Formal Case No. 326, at the request of the Commission, the Company made a study of the lag in the payment of bills and the lag in the payment of operating expenses. This study indicated that a net lag of 31.29 days was experienced in the collection of revenue. The Company's study produced results closely approximating the allowance for cash working capital arrived at by the application of the formula set forth above, and no change was made in that case. In preparation for this case, however, the Commission's staff made a study of the lag in payment of all taxes allowed as operating revenue deductions. This study (Exhibit 20) indicated that the lag in payment of expenses and taxes exceeded the lag in the collection of revenue by 19.9 days. After giving effect to the minimum bank deposits required to cover a portion of the cost of collection of bills by various banks, prepaid insurance, and special deposits, it appears that, on the basis of this study (which was predicated upon the identical data introduced by the Company in Formal Case No. 326 plus the computation of the lag in payment of taxes), the lag in the payment of expenses and taxes exceeds the lag in the collection of revenue by approximately \$350,000.

In the opinion of the Commission, there is no reason for treating taxes differently from any other operating expense item in the determination of the allowance for cash working capital. Pepco experiences a regular cycle in the collection of bills and the payment of expenses and taxes. So long as the revenues are collected generally in advance of the need for the payment of operating expenses and taxes, it does not appear that any allowance for cash working capital is necessary. For these reasons, the Commission finds that no allowance in the

rate base for cash working capital is warranted. The Commission further finds that the sliding-scale arrangement should be so modified as to permit reconsideration of this factor as changing conditions may require.

It has been the practice under the sliding-scale arrangement to exclude from the rate base property constructed with funds derived from contributions in aid of construction and deposits for extensions. The Commission finds no reason to change this practice.

Based upon the foregoing, the Commission finds that the gross rate base for the 12 months ended December 31, 1943, unweighted and weighted, is as shown in the following table:

	<i>Unweighted</i>	<i>Weighted</i>
Original cost of electric plant 12/31/43 -----	\$102,434,682.29	\$98,633,399.89
Contributions in Aid of Construction -----	(2,571,078.50)	(2,508,396.84)
Deposits for Extensions -----	(72,359.70)	(71,744.81)
Materials and Supplies -----	2,562,581.28	2,562,581.28
Gross Rate Base -----	<u>\$102,353,825.37</u>	<u>\$98,615,839.52</u>

The record is replete with evidence and arguments in favor of the adoption of a depreciated rate base, in preference to a continuation of the present method of calculating return on an undepreciated rate base, with an allowance of 4% on the depreciation reserve as a reduction in the depreciation accruals allowed the Company for rate-making purposes. Pepco witnesses, however, testified that there should be no change in the present arrangement.

The interveners argue that if the present method is to be continued, the interest rate on the depreciation reserve should be the same as the rate of return, citing the case of *Federal Power Commission v. Natural Gas Pipe Line Company*, 315 U. S. 575, in support of their position. The same contention was made in *Vinson v. Washington Gas Light Company*, 321 U. S. 489, based upon the decision in the *Natural Gas Pipe Line Company* case. This contention was rejected by the court as "unsupported by our cases." Moreover, in the *Natural Gas Pipe Line* case, the sinking-fund method of accruing

depreciation was used, whereas, in the *Washington Gas Light* case, as also in this proceeding, a modified straight-line method has been employed. These contentions overlook the fact that an interest rate different from the rate of return can be used under the sliding-scale method, if the depreciation reserve is treated as a source of funds in the determination of the cost of capital, and the rate of return is modified accordingly. By using an undepreciated rate base and deducting interest on the reserve balance from the depreciation accruals, and giving effect to the interest rate applied to the reserve in fixing the rate of return, the result obtained is the same as that arrived at by the use of a depreciated rate base. That this is so is demonstrated by Exhibit No. 35, introduced by V. A. McElfresh, Chief Accountant of this Commission, and not contradicted.

While the sliding-scale method of providing for depreciation has produced satisfactory results, it is not now in line with current thought on the subject. It is believed that the adoption of a depreciated rate base will result in desirable simplification and clarity, and that it will, under the same accrual rates, produce identical results to Pepco and consumers as would the continued use of the complicated and confusing sliding-scale method.

Therefore, the Commission is of the opinion and finds that, for the purposes of this proceeding and as a further modification of the sliding-scale arrangement, a depreciated rate base should be employed as a basic element of the arrangement in the determination of rate adjustments for the year 1944 and thereafter.

Discussion of the amount of the depreciation reserve to be deducted from the rate base in this proceeding, and provisions relating to depreciation accruals to be employed in the future, is had in subsequent sections of these findings.

THE DEPRECIATION RESERVE

The major portion of the depreciation reserve of Pepco has been developed in accordance with the method of accruing de-

preciation set forth in the sliding-scale arrangement, although the Company has for several years contended that the accrual rates provided in the arrangement should be increased. Briefly, the method has been described as a modified straight-line basis of depreciation. Under the arrangement, the depreciation reserve has increased from slightly less than \$4,000,000 in 1924 to \$16,667,162 as at December 31, 1942. This reserve is approximately 17% of the book cost of electric plant in service on that date.

As previously explained, the arrangement provides for a reserve which, at its maximum, will not exceed 20% of the rate base. Another salient feature of the development of the depreciation reserve is the provision that interest on the reserve be accrued on a 4% basis as an accretion to the reserve, thus lessening the amount of depreciation to be included as an expense of operation.

As one of the matters listed for investigation in the present proceeding deals with modifications, if any, that shall be made in the provisions of the present sliding-scale arrangement relating to depreciation accruals, the Federal Power Commission, at the request of this Commission, made available the services of C. W. Smith, who testified at length on the subject of depreciation.

Witness Smith adopted as the best explanation of depreciation the description contained in the 1943 report of the Depreciation Committee of the National Association of Railroad and Utilities Commissioners, which reads as follows: "(a) Depreciation is the expiration or consumption, in whole or in part, of the service life, capacity, or utility of property resulting from the action of one or more of the forces operating to bring about retirement of such property from service; (b) the forces so operating include wear and tear, decay, action of the elements, inadequacy, obsolescence, and public requirements; (c) depreciation results in a cost of service." This Commission concurs in the view that the foregoing description of the depreciation phenomenon is an excellent one.

In connection with his testimony, witness Smith presented and explained various exhibits which had been constructed by

the staff of this Commission by the employment of rates of depreciation developed by him.

Exhibit No. 31, introduced by witness Smith, reflected accrued depreciation calculated as that percentage of cost of plant which the expired life bears to the total life of such plant. It was explained that this method, although frequently used, contains a rather serious error in that it does not take into consideration the retirements which were made during the early years of the life of properties, which early retirements will be offset by properties having a longer-than-average service life. In other words, it does not take into consideration what is sometimes called "infant mortality." For that reason, the conclusion was reached by the witness that the reserve requirement determined by this method necessarily reflects an excessive amount. Therefore, he recommended that the reserve requirement of approximately \$24,000,000 reflected in Exhibit 31 be not used by the Commission.

Exhibit No. 32, presented by the same witness, reflects the computation of depreciation reserve as it would be if Pepco had used what he considered proper depreciation rates. The witness explained that this method has one very desirable feature in that it recognizes the actual retirements which were made at the times they were made, thus correcting automatically for premature retirements in the early years of the life of the property by recognizing the actual rather than the theoretical retirements. It is the opinion of witness Smith that the adjusted reserve balance of \$19,367,785 shown on Exhibit 32 as at December 31, 1942 is a reasonable estimate of reserve requirement.

Despite the fact that the reserve requirement calculated under the method employed in Exhibit 32 is approximately \$2,700,000 greater than the book reserve as at December 31, 1942, the witness recommended that the book reserve be accepted by the Commission for the purposes of this proceeding. He explained that this conclusion was reached because of the restrictions with respect to depreciation which were imposed in the sliding-scale arrangement. He further expressed the belief that where a utility has been restricted as to the amount

of depreciation expense by a regulatory commission having jurisdiction, it is not proper, nor is it equitable, to adopt a higher reserve requirement than that developed under regulatory authority, particularly where, as in the District of Columbia, the sliding scale provides for annual rate investigations.

The witness testified that in his opinion the present provisions with respect to the annual accrual for depreciation have resulted in the creation of an inadequate depreciation reserve, and that the perpetuation of these provisions will never permit Pepco to build up an adequate reserve. He recommended the removal of the maximum limitation of 20% on the reserve (as did other witnesses), and also a modification of the provisions for annual accruals to the reserve.

F. A. Sager, Chief Engineer of this Commission, introduced testimony (Exhibits Nos. 36, 37, and 38) relative to his estimate of depreciation reserve based upon the assumption that the straight-line method, using accrual rates hereinafter discussed, had been employed throughout the existence of the sliding-scale arrangement. The witness concluded that a depreciation reserve requirement, developed in this manner, would be \$21,600,000 (R. 1362).

Max Mason, Survey Engineer of Pepco, testified and introduced testimony (Exhibits Nos. 54 to 58, inclusive) purporting to show that the book depreciation reserve of Pepco as at December 31, 1943, in the amount of \$18,611,702.95, will provide separately for (1) the accrued depreciation applicable to property scheduled for retirement within the next 10 years; (2) accrued depreciation applicable to property not scheduled for retirement; and (3) a reserve of \$1,262,472.80 for unforeseen retirements. The witness stated, however, that this latter amount might be somewhat inadequate, although he expressed no idea as to the amount by which it might fall short of actual requirements.

It is generally recognized that the determination of depreciation reserve requirement, on any basis, is necessarily an estimate. In its 1943 report, the Committee on Depreciation of the National Association of Railroad and Utilities Commis-

sioners carefully reviews the necessity for exercising caution in making adjustments to the depreciation reserve, in the absence of obvious serious reserve deficiencies. The history of depreciation practices of Pepco through the years, as pointed out by witness Smith, reveals the fact that the Company has built up a reserve that has been consistently more favorable than for the average utility company.

It appears, however, that this favorable position will not be maintained without modification of the depreciation provisions of the sliding-scale arrangement. For this reason, the Commission finds that the 20% limitation on the depreciation reserve should be removed. Discussion of modified annual accrual rates will be found in the succeeding section of these findings.

After careful consideration of the record and in view of the fact that the depreciation practices employed by Pepco have been prescribed by this Commission, the Commission finds that, for the purposes of this proceeding, the depreciation reserve as of December 31, 1943 is \$17,844,120.48 on a weighted basis, as hereinafter developed under the caption, "Rate Reduction Warranted." The unweighted depreciation reserve as of December 31, 1943, is \$19,073,869.60. The Commission further finds that the weighted reserve constitutes a fair and reasonable determination of accrued depreciation for application in establishing a depreciated rate base under the modified sliding-scale arrangement.

PROVISION FOR DEPRECIATION

Evidence on the question of the proper annual accrual for depreciation was presented for the Commission by witnesses Smith and Sager and for Pepco by witness Mason. Commission witness Smith's Exhibit No. 30 sets forth the annual accrual rates of depreciation by primary electric plant accounts. These rates, the witness explained, were based on estimated average service lives for the various classes and groups of property included in the primary plant accounts, and they reflect an allowance for estimated net salvage in appropriate

cases. The rates are predicated on the witness's general knowledge of the depreciation problem, as well as a general knowledge of the property of Pepco. The application of these rates (Exhibit No. 34) to the depreciable plant of the Company, weighted insofar as net additions for the year 1943 are concerned, and excluding certain property classified as emergency facilities, results in an indicated accrual for depreciation for the year 1943 of \$2,600,896.95.

Commission witness Sager's Exhibit No. 36 sets forth accrual rates predicated solely on the estimated service life of the property included in the various primary plant accounts. Application of these rates to depreciable electric plant as of December 31, 1942, with an overall deduction of 14.2875% for net salvage, results in an indicated accrual of \$2,603,203.32 for the year 1943. The estimated service lives are predicated on the witness's general engineering knowledge and his specific knowledge of the property of Pepco, gained by frequent inspections during his nearly 14 years of service with the commission. The overall percentage for net salvage was determined by the witness from a study of the net salvage recovered during the period 1925 to 1942, inclusive, in relation to the total retirements of depreciable property during the same period.

Pepco witness Mason testified that his studies indicated the annual accrual for depreciation for the year 1943, made in the same manner as the accrual for the year 1944, set forth on Statement B of Exhibit 55, should be \$2,770,000. The witness employed the retirement-forecast method of determining the annual accrual. This method assumes that factors causing retirement of property other than wear and tear and action of the elements are not predictable until property is scheduled for retirement, and that provision for the other factors causing retirements, such as obsolescence, governmental requirements, etc., is not necessary until 10 years prior to the time that the property is scheduled for retirement. Obviously, this method necessitates the application of abnormally low accrual rates to all property not scheduled for retirement within the next 10

years, and abnormally high accrual rates to property scheduled for retirement in 10 years.

A precise comparison of the accrual rates presented by witness Smith with those presented by witness Sager cannot be made because of the different treatment of salvage by the two witnesses. Likewise, the rates used by witness Mason cannot be compared with those used by either Smith or Sager, for the reason that the rates accrued by Mason for property not scheduled for retirement, while applying to approximately 73% of the property, account for only about 35% of the annual accrual. The remaining accrual is primarily the difference needed to absorb, over a 10-year period, the deficiency in the accrual prior to the date the property was scheduled for retirement within 10 years. In total, however, the annual accrual computed by the three witnesses is remarkably close, and the Commission, therefore, is concerned primarily with the question of deciding which of the three methods should be adopted.

As to the method used by Pepco witness Mason, the Commission recognizes the difficulty of predicting with precision the retirement of property caused by factors other than wear and tear and the action of the elements. It is believed, however, that the prediction of retirements due solely to such causes is just as difficult, and that actual results will undoubtedly vary considerably from predicted estimates. As the Commission views the depreciation problem, it is essentially an attempt to predict as nearly as possible the estimated lives of the various types and classes of property, to the end that the cost of such property might be charged against the income produced by it in the most equitable manner throughout its useful life. All of the factors causing the ultimate retirement of property should be considered in determining the rate to be applied to the cost of property during its useful life. The method used by Pepco witness Mason does not meet this requirement, and for this reason it is not adopted for the purposes of this proceeding.

The Commission recognizes the impossibility of determining precisely the amount which should be accrued annually for

depreciation. The computation presented by witness Smith indicates a composite accrual rate of 2.69% of depreciable property, while that of witness Sager reflects a composite rate of 2.77%. Witness Smith based his calculations on depreciable plant, which included weighted net additions for the year 1943, whereas witness Sager's was based upon depreciable plant as at December 31, 1942.

Both witnesses use the straight-line service-life method. While these rates are not predicated on mortality studies of the property of Pepco, they reflect the experience and judgment of these two witnesses and, in the opinion of the Commission, are predicated on sound principles.

After carefully weighing all the evidence, it is the judgment of this Commission that, for the purposes of this proceeding, the provision for depreciation of depreciable property other than emergency facilities, applicable to the test year 1943, should be that reflected in Exhibit No. 34, or \$2,600,896.95. The provision for depreciation on Pepco's books for the year 1943 includes \$71,852.18 covering depreciation on transportation equipment and certain tools and work equipment which has been charged to clearing accounts. While there is some slight difference in the rates used in determining the accrual so charged in comparison with the rates used on Exhibit No. 34 for similar property, the difference is not material, and to eliminate the necessity for adjustment the Commission believes that this amount should not be disturbed. This means that only \$2,529,044.77 of the total provision for depreciation will be treated as an operating revenue deduction. The Commission is of the further opinion that the depreciation reserve on the books of Pepco as at December 31, 1943 should be adjusted, with a corresponding charge to surplus, to reflect the provision for the calendar year (which corresponds to the test year) in the amount just stated.

The Commission finds that the annual provision for depreciation, both for book purposes and for rate-making purposes, shall be at the rate of 2.7% of depreciable property. The Commission believes that this rate will fairly spread over the expected life of the property the consumption of capital in-

vested and will maintain the integrity of that investment. The sliding-scale arrangement shall be modified to so provide. In the modified arrangement, provision should be made for periodic review of the entire subject of depreciation, to the end that suitable and timely adjustments may be made in conformity with requirements of changes in the art and consistent with prudent management.

Reference has been made heretofore to the amortization of emergency facilities. The major portion of the approximate cost of \$600,000 of these facilities covers a transmission line to the Naval Powder Factory at Indian Head, Maryland, which is expected to be retired shortly after the cessation of hostilities. This line and the other facilities similarly classified were constructed only after approval by the Secretary of the Navy as being necessary to the war effort, and regulations of the Internal Revenue Bureau permit the amortization of the cost of such facilities over a 5-year period in the determination of taxable income. Pepco also received certificates of necessity for construction of other property at a cost considerably in excess of that under discussion, but by reason of the fact that this property, in the judgment of the Company, will probably remain in service throughout its useful life, it is not being amortized over the allowable 5-year period for either corporate or income tax purposes.

The Commission believes that the estimated life of these emergency facilities is the controlling factor in the determination of the question whether the cost thereof should be amortized over a 5-year period, or depreciated normally with other similar property. The transmission line to the powder plant provides supplemental service, and under normal conditions the powder plant, which has been in operation for a great many years, generates sufficient power for its own needs. The major portion of the transmission line is located in a territory served by another utility, and there is no likelihood that additional customers will be connected. In view of these facts, the Commission finds that the amortization of these emergency facilities over a 5-year period is reasonable and proper and allows for the year 1943 the sum of \$229,673.82 for amortiza-

tion thereof. This allowance covers amortization for the years 1942 and 1943 which was entered on the books of Pepco after approval by the Commission.

THE RATE OF RETURN

On the subject of rate of return, direct testimony supported by documentary evidence was introduced for the Commission by its Chief Accountant, V. A. McElfresh, and for Pepco by R. Roy Dunn, Assistant to the President. Opinion testimony without supporting data was offered by several other witnesses.

The evidence on this subject presented by witness McElfresh was predicated upon the cost-of-capital theory. This Commission, in its Order No. 2682, adopted the cost-of-capital method in the determination of the rate of return to be allowed the Washington Gas Light Company. Since that order was issued, the Supreme Court approved this method in *Federal Power Commission v. Hope Natural Gas Company*, 320 U. S. 591.

It is the opinion of this Commission that the cost-of-capital method of determining the rate of return in the rate-making process is particularly well adapted to a sliding-scale arrangement. This is so because of the annual rate adjustment feature, which permits a prompt reflection of changing economic conditions in the rates for service. In the absence of a sliding-scale arrangement, it is presumed that rates fixed after protracted investigation and hearing will remain in effect for several years, and consequently forecasts as to the effect of possible future changes must play an important part in such deliberations. Under the sliding-scale arrangement, the use of actual results of a test year as a basis for the adjustment of rates for the succeeding rate year minimizes the necessity for reflecting in rates the effect of future conjectural changes which may or may not materialize. In other words, under the arrangement the adverse effect of abrupt or violent changes in the return to the Company or rates charged to consumers is limited to a single year's operations.

The cost-of-capital method, which employs the actual cost of long-term debt capital and preferred-stock capital—provided, of course, that such costs are reasonable—limits the rate of return problem to a determination of a reasonable return on the common stockholders' investment. This question, however, is not simple to resolve, for the common stockholders are the ones who are most seriously affected by the business cycle. The rate-making process involves an equitable balancing of the interests of the common stockholders of the utility against the interests of consumers. The cost-of-capital method of fixing the rate of return, coupled with the sliding-scale arrangement, will, in the opinion of the Commission, effectively achieve such a balance.

A. Long-Term Debt Capital

In his general presentation of evidence relating to the cost of long-term debt capital, Commission witness McElfresh introduced data (Exhibit No. 22) classified as follows:

1. Moody's bond yield averages based on bonds of 120 domestic corporations, composite and according to ratings.
2. Moody's bond yield averages based on bonds of 120 domestic corporations, under three principal classes—namely, industrials, public utilities, and railroads—and on a composite basis.
3. Moody's bond yield averages based on bonds of 40 public utilities, according to ratings.

Witness McElfresh also introduced data (Exhibit No. 23) relating to bond issues of electric utilities during the years 1942 and 1943, reflecting the cost to the issuing companies and the yield to the buyers applicable to the issues by ratings.

The evidence shows that the yield on long-term debt capital has declined sharply in recent years. For instance, the yield on ten public utility bond issues rated AAA (the rating presently applied to Pepco bonds) in 1920 was 6.53%, while in September 1943 the yield on similarly classified bonds was but 2.64%. (See Exhibit No. 22.) A corresponding decline was experienced in yield on public utility bonds having lower ratings.

The evidence also shows that during the year 1942, two issues of electric utility bonds having a rating of AAA, in the aggregate principal amount of \$20,000,000, were sold at a cost to the issuing companies of 2.82%.

The presently outstanding long-term debt of Pepco, and the effective interest rate, by issues, is shown in the following tabulation:

<i>Issue</i>	<i>Principal Amount</i>	<i>Effective Interest Rate</i>
First Mortgage, 3¼%, due July 1, 1966:		
Issued July 1, 1936 -----	\$15,000,000	3.217%
Issued November 29, 1937 -----	5,000,000	3.267
	<u>\$20,000,000</u>	<u>3.230%</u>
First Mortgage, 3¼%, due December 1, 1974:		
Issued December 1, 1939 -----	\$ 5,000,000	2.991%
First Mortgage, 3¼%, due August 1, 1975:		
Issued September 11, 1940 -----	\$ 3,334,000	2.796%
Issued December 11, 1940 -----	3,332,000	2.795
Issued March 11, 1941 -----	3,334,000	2.794
	<u>\$10,000,000</u>	<u>2.795%</u>
First Mortgage, 3¼%, due August 1, 1977:		
Issued September 4, 1942 -----	\$ 5,000,000	2.635%
Total -----	<u>\$40,000,000</u>	<u>3.008%</u>

The Commission finds that, for the purposes of this proceeding, the cost of long-term debt capital of Pepco is 3.008%.

B. Preferred-Stock Capital

Evidence was presented by Commission witness McElfresh (Exhibit No. 24) bearing upon the cost to issuing companies and yield to the public of recently issued preferred stocks of electric utilities. This evidence shows that during the year 1942 preferred stocks were issued by four electric utilities, at a weighted average cost of 4.93% to the issuing companies, and at a weighted average yield of 4.82% to the purchasers.

The cost to the four companies involved ranged from 4.00% to 6.60%. During the year 1943, four additional issues were sold at a weighted average cost of 4.53%, and a weighted average yield of 4.38%. With respect to these issues, the cost to the issuing companies ranged from 3.93% to 5.37%.

The cumulative preferred stock of Pepco now outstanding consists of 20,000 shares of 6% Series of 1925 and 50,000 shares of 5½% Series of 1927. The net proceeds from the sale of the 6% Series amounted to \$1,933,891.77, and \$4,804,393.49 was realized from the sale of the 5½% Series.

Schedule 3 of Exhibit 26 introduced by witness McElfresh shows that the annual cost of the \$7,000,000 of preferred-stock capital of Pepco now outstanding is 5.862% per annum. This figure was determined by relating the annual dividends to the net proceeds derived from the sale of these securities. The annual cost of 5.862% is considerably higher than the cost of recently issued preferred stocks of electric utilities of comparable investment qualities. This fact was pointed out by the Commission's witness who stated that in his opinion the \$7,000,000 of preferred stock now outstanding could be called and a new issue floated at a cost of not more than 5% per annum including the 7% call premium. This opinion is shared by Pepco and by the other parties to this proceeding. Thus, it appears that 5% is a reasonable allowance for the cost of preferred-stock capital, and the Commission so finds.

C. Equity Capital

As previously indicated, the principal difficulty encountered in the cost-of-capital method of determining a fair rate of return relates to the equity capital component of the total invested capital. Commission witness McElfresh introduced evidence and testified at length on this subject. Pepco witness Dunn also presented extensive testimony relative to the treatment to be accorded equity capital in a cost-of-capital study.

Pepco presently has outstanding 90,000 shares of common stock of \$100 par value per share, all of which is owned by its

immediate parent, Washington Railway and Electric Company. The recorded book equity applicable to this stock as at September 30, 1943 (the date as of which the cost-of-capital study was made) was as follows:

Common Stock	
90,000 shares at \$100 par value per share -----	\$ 9,000,000
Earned Surplus -----	29,088,514
Total Equity, per books -----	\$38,088,514

In his calculation, Commission witness McElfresh made various adjustments, not opposed by Pepco, to the amount of equity recorded on its books, which adjustments are explained immediately below:

1. Elimination from the common capital account of \$1,000,000.

Explanation—Of the 90,000 shares of common stock outstanding, 10,000 shares were issued in the year 1912 for certain rights in a power site located at the Great Falls on the Potomac River. The title to this site has not yet been vested in Pepco. The site has not been developed. This investment of \$1,000,000 has never been included in the rate base.

2. Deduction of the amount of \$3,429.46 from the common capital account.

Explanation—This amount represents capital stock expense recorded on the books of Pepco at September 30, 1943.

3. Addition to earned surplus in the amount of \$194,615.21.

Explanation—This adjustment is made in order to restore to earned surplus, for the purposes of the cost-of-capital determination, unamortized debt discount and expense applicable to refunded debt issues, which amount had previously been written off the books of Pepco.

4. Addition to earned surplus in the amount of \$160,415.00.

Explanation—This adjustment is made in order to restore to earned surplus, for the purposes of the cost-of-capital determination, discount and expense applicable to preferred-stock issues, which amount had previously been written off the books of Pepco.

As a result of the adjustments enumerated above, the common-stock equity is considered to be \$37,440,115.16 for the purpose of calculating the average cost of invested capital as at September 30, 1943.

It is deemed appropriate to explain at this point that, at the time the reclassification of the fixed capital accounts of Pepco was completed in accordance with orders issued by the Federal Power Commission and by this Commission, all differences between original cost and the book cost of property were

eliminated from the plant account of Pepco, with corresponding charges against earned surplus and other appropriate accounts. Thus, no inflationary or improper amounts are reflected in the equity capital as presently constituted and used in this study of cost of invested capital.

In connection with his study of the return to be allowed on equity capital in a cost-of-capital computation, the Commission's witness presented statistics (Exhibit No. 25) setting forth the earnings-price ratios and the dividend-price ratios applicable to the common stocks of 14 selected electric operating utilities. The utility companies selected comprise a substantially complete list of electric operating companies whose common stocks are traded on national exchanges. They operate in various sections of the country.

It is recognized by the Commission that the results obtained by comparisons are not in themselves conclusive. They do serve a useful purpose, however, as a guide in the exercise of the judgment necessary in reaching a final determination. In the present instance, the Commission does not have the benefit of actual experience relating to investor appraisal of the common stock of Pepco, as none of this stock is traded on the open market. However, from a statistical standpoint, Pepco compares more than favorably with the average of the 14 electric utilities, on such points as coverage for income deductions and preferred-stock dividend requirements, ratio of common-stock equity to total capitalization, and the proportion of gross income available for common stock.

The earnings-price ratios and the dividend-price ratios were calculated by Commission witness McElfresh for the years 1939, 1940, 1941, and 1942, for the 12 months ended September 30, 1943, and for the 3 months October to December 1943, inclusive. The average of the high and low prices during each of the periods was first obtained and related to the earnings for the period in order to derive the pertinent ratios. Next, a simple average and a weighted average of such ratios were calculated for the entire period. These calculations resulted in a simple average earnings-price ratio, for the six periods covered, of 7.77% and a weighted average earnings-price ratio of 7.82%.

Dividend-price ratios obtained were 6.73% on a simple average basis and 6.89% on a weighted average basis.

Objection was raised by Pepco to the use of interim income figures for the 12 months ended September 30, 1943, and to the calculation of earnings-price ratios for two periods during the year 1943. Pepco witness Dunn made a new calculation based on the data shown on Exhibit No. 25, using income for the year 1943 related to the average of high and low prices during the same year. This calculation (Exhibit No. 63) increased the simple average shown on Exhibit No. 25 from 7.77% to 7.88% and the weighted average from 7.82% to 8.04%. The combining of the two 1943 periods used in Exhibit No. 25 tends to lessen the effect on earnings-price ratios of the general increase in the price of common stocks which occurred in the latter part of the first quarter of 1943 and which has continued generally at the same level to the present time. In order to give proper weight to the current conditions of the market, witness McElfresh recalculated the data shown on Exhibit No. 25, by combining the two 1943 periods used thereon and using income for the year 1943 instead of for the 12 months ended September 30, and made a further calculation based on earnings for 1943 and the average of high and low prices obtaining from January 1 to March 18, 1944. This calculation (R. 2235) produced a simple and weighted average of 7.70%.

The Commission, after weighing all the evidence on this matter, concludes and finds that a return of 8% on the common-stock equity constitutes a liberal return and is commensurate with returns on investments in other enterprises having corresponding risks. This return is sufficient to assure confidence in the financial integrity of Pepco and will attract capital for future public needs.

D. Conclusions as to Rate of Return Based upon Cost of Capital Invested

The average cost of invested capital of Pepco as at September 30, 1943 is summarized below:

Source of Funds	Invested Capital	Cost on an Annual Basis	
		Rate	Amount
Long-Term Debt -----	\$41,579,545	3.008%	\$1,250,713
Preferred Stock -----	6,738,285	5.862	395,000
Common-Stock Equity:			
Common Stock -----	\$8,996,571		
Less—Investment in Great Falls Power Site -----	1,000,000		
	<u>7,996,571</u>		
Earned Surplus -----	29,443,544	37,440,115	8.000
			2,995,209
Customers' Deposits—Active -----	1,160,769	5.000	58,038
Interest Accrued—Active Deposits -----	292,504	----	
Customers' Deposits—Inactive -----	30,675	----	
Interest Accrued—Inactive Deposits -----	17,144	----	
	<u>\$87,259,037</u>	<u>5.385%</u>	<u>\$4,698,960</u>

The foregoing tabulation includes the presently outstanding preferred stock at its current annual cost to Pepco. As already determined, the Commission is of the opinion that, for this study, a cost of 5% more accurately reflects a reasonable allowance for cost of preferred stock of Pepco. After giving effect to this adjustment, the overall cost of invested capital becomes 5.319%.

After careful consideration of the record in this proceeding and in view of the favorable financial position of Pepco, the prospects for continued growth of population in the territory served by it, and the cost of invested capital as set forth above, the Commission concludes and finds that a basic rate of return of 5½% is fair and reasonable. This rate, when applied in the modified sliding-scale arrangement prescribed herein, will, in the opinion of the Commission, meet the oft-repeated judicial requirement⁵ that the return to a utility be such as to enable it (under efficient and economical management) to meet all of its capital obligations and to provide an amount for the payment of reasonable dividends and the retention in surplus of a reasonable amount of earnings, thus maintaining

⁵ See for example: *Bluefield Water Works & Improvement Co. v. Public Service Com.* (1923), 262 U. S. 679; *United Railway & Electric Co. v. West*, 280 U. S. 234; *Federal Power Commission v. Hope Natural Gas Company*, 320 U. S. 591.

its credit and enabling it to continue to attract capital on favorable terms for the proper discharge of its public duties. Should a rate base other than one premised on original cost or prudent investment be used, the rate of return would be substantially less than that determined herein to be reasonable.

METHOD OF EFFECTING RATE ADJUSTMENTS

During the present proceeding, the following questions were raised for the consideration of the Commission in connection with the method of effecting rate adjustments:

1. Whether rate adjustments should be based upon actual operating experience or upon forecasts of future operating results.
2. What portion of excess of return should be applied to rate reductions.
3. Whether rate adjustments are to be reflected in gross operating revenues or net operating income.

The present sliding-scale arrangement uses the results of operations during a test year (which is the calendar year) in order to ascertain the return earned on the rate base. The record does not contain any sound reason for the abandonment of this practice. The only alternative would be the adoption of the forecast method, which at best is conjectural and unreliable, and which is particularly vulnerable in these respects during such periods of uncertainty as now prevail. The experience of the Commission during the early years of sliding-scale operation, when it was necessary to project earnings and rate base over a portion of the test year, demonstrated the unreliability of such projection. The record shows that budget estimates of the Company require constant review and revision, which again demonstrates the unreliability of rate determinations based upon prognostications. Therefore, the Commission finds that the continued use of a test period for the determination of rate adjustments is sound and fair to both Pepco and the ratepayers, as it provides through actual experience a set of known and indisputable facts.

The provisions of the sliding-scale arrangement relating to the portion of the excess of return which should be applied to rate reductions have been set forth in detail on page 5 here-

in. The question to be resolved is whether these provisions should be retained with appropriate modification by reason of the change in the basic rate of return, or whether all of the earnings in excess of the basic return shall be applied as the basis for rate adjustments in the ensuing year. In the orthodox or traditional rate-making process it is general practice to determine the earnings in excess of the allowed return during a test period and then attempt to fix rates which, it is hoped, will yield only the allowed return. In this process there are many factors which operate as incentives to the utility, such as a rate base higher than the actual investment, the knowledge that the rates prescribed will obtain for a period of several years, and the fact that larger returns flowing from increased volume of business and operating economies will inure solely to the benefit of the utility.

In the sliding-scale arrangement, particularly in view of our adoption of an original-cost of prudent-investment rate base, the establishment of a basic rate of return predicated in major part upon the cost of invested capital, and provision for the annual adjustment of rates, the incentives present in the traditional rate-making process, to a large degree, have been eliminated. In view of these facts, the Commission is of the opinion that the use of all earnings in excess of the return allowed at the basic rate of return as a rate reduction is not warranted and that the present method of using only a portion of such excess earnings as a basis for reduction of rates should be continued, with the modifications necessary by reason of the reduced basic rate of return. It is here pertinent to point out that the return at the basic rate of $5\frac{1}{2}\%$ of the rate base is not the actual return allowed the Company before any reduction is made in rates for the ensuing rate year, but is that amount plus a portion of the earnings in excess of such return. During the year under consideration, the allowed return is therefore 5.82%. Hence, it is evident that the use of only a portion of the earnings in excess of the basic return operates not only as an incentive to Pepco, but as a safety factor upon the Commission's judgment.

With respect to the third question, which relates to the

method of applying rate adjustments, reference is again made to the provisions covering this point which are set forth on page 5 herein, as well as to the original provisions of the consent decree set forth on page 4. It is clear that the rate reductions effected under the operation of the sliding scale have been in strict accord with these provisions. In other words, the arrangement provides that the rate reduction shall be applied against the gross operating revenues of Pepco, rather than against its net operating income.

In this proceeding, the Commission has given careful consideration to the evidence on this question, to all of the factors embraced by the sliding-scale arrangement, and to the overall effect of the various modifications proposed herein. Because of the high level of income taxes now in effect, particularly where a utility is subject to excess profits taxes, it is obvious that a substantial reduction in gross operating revenue would have only a nominal effect upon net operating income. That this conclusion is warranted with respect to Pepco is clearly demonstrated by the record in this proceeding. To continue to apply rate reductions to gross operating revenues rather than to net operating income would provide an additional return over and above that found to be fair and reasonable. It is recognized that in the event future earnings should fall below the basic rate of return, the upward adjustment of rates would include provision for increased income taxes that would be occasioned thereby. However, the Commission concludes, in view of the facts set forth above, that the amount found to be available for rate adjustments should be reflected in the net operating income of Pepco by giving proper recognition to the effect upon its income-tax liability resulting from the decrease or increase in gross revenues, and that the sliding-scale arrangement should be modified accordingly. A reduction in gross revenues, of course, results in a reduction of all taxes relating to income, but, because of the relatively minor effect of rate changes on all taxes except Federal income and excess profits taxes, the Commission finds that the effect upon Federal income and excess profits taxes only should be considered in determining rate adjustments.

The Commission finds that rate adjustments should be predicated upon the results of operation during the test year (calendar year). Whereas the present arrangement provides that rate adjustments shall be absorbed over a 10-month period, commencing March 1 of each rate year, the Commission finds that it would be more equitable to spread such adjustments over the entire rate year, and that the sliding-scale arrangement should be so modified.

RATE REDUCTION WARRANTED

In view of the conclusions drawn and the findings made herein, the Commission further finds that a reduction in rates in the aggregate amount of \$1,037,189 is warranted.

The following tabulation will serve to demonstrate the method by which the amount of the rate reduction has been determined:

Gross operating revenues	\$22,531,096.22	
Amortization of Impounded Fund	16,332.42	
		\$22,547,428.64
Operating Revenue Deductions:		
Operation and Maintenance	\$10,581,524.22	
Depreciation Accrual	2,529,044.77	
Amortization of Emergency Facilities	229,673.82	
Taxes, other than Federal Income and		
Excess Profits Taxes	1,834,311.17	
Federal Income and Excess Profits Taxes	2,416,000.58	
		17,590,554.56
Net Operating Income		\$ 4,956,874.08
Return @ 5½% on Rate Base of \$80,771,719.04 ^c		4,442,444.55

^c Weighted gross rate base (See page 20) \$98,615,839.52

Less:

Depreciation reserve adjusted and weighted—

Book reserve 12/31/42 (See p. 22)	\$16,667,163.19	
Book adjustment of above balance	(52,791.84)	
Accrual for year 1943, weighted	1,200,448.48	
Amortization of Emergency Facilities for 1942 and		
1943, weighted	114,836.91	
Net Retirement Losses during 1943, weighted	(185,536.26)	
		17,844,120.48

Depreciated Rate Base for year 1943, weighted \$80,771,719.04

The unweighted Rate Base at 12/31/43 amounts to \$83,279,955.77

Earnings in Excess of Basic Return -----	\$ 514,429.53
Reduction in Net Income Necessary -----	257,214.77
Savings in Federal Income and Excess Profits Taxes Resulting from Reduction in Net Income -----	779,974.51 ⁷
Rate Reduction -----	<u>\$ 1,037,189.28</u>

In arriving at the amount of net operating income shown in the foregoing tabulation, the recorded costs of operation and maintenance have been reduced by \$33,210.06 as set forth in detail on Schedule 3 of Exhibit No. 12. Federal income and excess profits taxes reflect the total liability of the Company for the year 1943 on a consolidated basis. Adjustment of an over-accrual for the year 1942 in the amount of \$35,571.79 is also reflected in the Federal income and excess profits tax figure shown in the foregoing tabulation.

The recorded net income of Pepco for the year 1943 amounted to \$4,181,453.11 (Exhibit No. 73). After adjusting for the additional accrual for depreciation found herein to be necessary, the adjusted net income would amount to \$3,902,308.66. Giving effect to the rate reduction of \$1,037,189.28 determined herein to be necessary, and to the estimated savings in Federal income and excess profits taxes of \$779,974.51 which would result from such a reduction in revenues, the pro forma net income would amount to \$3,645,093.89. After providing for preferred dividend requirement of \$395,035.11, the remaining \$3,250,058.78 would provide a return of 8.91% on the common-stock equity of Pepco at December 31, 1943. Such a return, in the opinion of the Commission, will enable Pepco to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed.

⁷ Calculated as follows:

Pepco's income subject to excess profits tax for the year 1943 amounted to \$890,484.86, which, if eliminated, would, at the excess profits tax net rate of 81%, effect a reduction in net income of \$169,192.12 or a tax savings of \$721,292.74. To further reduce net income by the difference between the total necessary reduction of \$257,214.77 and the reduction in net of \$169,192.12 set forth above, or \$88,022.65, a reduction in gross revenue or taxable income of \$146,704.42 would be necessary ($\frac{88,022.65}{80} \times 100$). The combined normal and surtax rate of 40% applied to this amount produces a tax savings of \$58,681.77, which, together with the \$721,292.74 set forth above, produces the total tax savings of \$779,974.51.

CONCLUSION

After full consideration of the entire record and briefs in this proceeding, the Commission concludes and finds that the modifications of the sliding-scale arrangement prescribed herein are in accord with law and just and reasonable; and that the rate reduction herein set forth and resulting from the application of the sliding-scale arrangement as so modified to the operations of Pepco during the test year ended December 31, 1943 will produce just and reasonable rates, and enable the Company to earn a fair return.

An appropriate order will issue.

By the Commission:

E. J. MILLIGAN,

Executive Secretary.

PUBLIC UTILITIES COMMISSION OF THE
DISTRICT OF COLUMBIA

Order No. 2796

July 22, 1944.

P. U. C. No. 3362
Formal Case No. 335
P. U. C. No. 3377
Formal Case No. 338

IN THE MATTERS OF

POTOMAC ELECTRIC POWER COMPANY

Sliding-Scale Arrangement and Investigation of Rates, Tolls,
Charges, Rules, Regulations, and Conditions of Service

In accordance with the findings and opinion rendered in
these proceedings,

IT IS ORDERED:

Section 1. That the existing sliding-scale arrangement for electric rate adjustments be, and it is hereby, modified in accordance with the findings and opinion in these proceedings.

Section 2. That Potomac Electric Power Company be, and it is hereby, directed to file within 30 days from the date hereof, new rate schedules which, when applied to kwh consumption during the test year 1943, will reduce its gross operating revenues by the amount of the rate reduction herein found to be necessary; namely, \$1,037,189.

Section 3. That such new schedules ordered to be filed in Section 2 hereof, when approved by the Commission, shall be in force and effect in respect to all meter readings taken on and after March 1, 1944, in accordance with the provisions of the sliding-scale arrangement as modified by the findings herein, and shall continue in effect until February 28, 1945, or until further order of this Commission.

Section 4. That the depreciation reserve recorded on the books of Potomac Electric Power Company as of December 31, 1943 be adjusted in accordance with the findings herein.

Section 5. That, effective January 1, 1944, and until further order of this Commission, provision for depreciation, both for corporate and rate-making purposes, shall be at the rate of 2.7% per annum of the recorded cost of depreciable property.

A True Copy:

By the Commission:

Chief Clerk.

E. J. MILLIGAN,
Executive Secretary.

District Court of the United States

DISTRICT OF COLUMBIA

Civil Action No. 26401

UNITED STATES OF AMERICA, PETITIONER

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
AND JAMES H. FLANAGAN, JAMES F. REILLY, AND CHARLES
W. KUTZ, CONSTITUTING THE PUBLIC UTILITIES COMMISSION
OF THE DISTRICT OF COLUMBIA, RESPONDENTS

**Petition of Appeal by the United States of America From
the Findings, Opinion, and Order of the Public Utilities
Commission of the District of Columbia, No. 2796, Dated
July 22, 1944.**

The United States of America (hereinafter called the "petitioner"), pursuant to the provisions of Paragraph 65 of Section 8, Ch. 150, Act of March 4, 1913, 37 Stat. 974, as amended, now District of Columbia Code (1940) Sections 43-704 and 43-705, files this petition of appeal from the "Findings, Opinion, and Order No. 2796" of the Public Utilities Commission of the District of Columbia (hereinafter called "the Commission") dated July 22, 1944, and says:

1. The Commission is an administrative body created by and functioning with the powers and duties prescribed in the District of Columbia Code (1940) (hereinafter called "the Code"). James H. Flanagan, James F. Reilly, and Charles W. Kutz are presently the members of the Commission.

2. Potomac Electric Power Company (hereinafter called "Pepco") is a corporation organized and existing under the laws of the United States applicable to the District of Columbia, and is a "public utility," as defined in Title 43 of the Code, engaged in generating and selling electric energy. It is subject to control and regulation by the Commission as provided in the Code. The

order appealed from purports to establish reasonable, just, and nondiscriminatory rates to be charged Pepco's customers for electric energy during the calendar year 1944.

3. The petitioner is a consumer of electric energy supplied by Pepco, and has been such a consumer since the organization of Pepco. It is Pepco's largest customer, paying approximately \$6,000,000 a year, which is about one-fourth of Pepco's gross revenue. The petitioner is vitally interested in the rates which may be charged by Pepco under orders of the Commission, and is affected by the Commission's Order No. 2796.

4. The petitioner, acting through the Public Buildings Administration of the Federal Works Agency and through the Treasury Department by its Director of Procurement, intervened in, and was a party to, and actively participated throughout, the proceedings and hearings before the Commission which culminated in its Order No. 2796.

5. Pursuant to Section 43-704 of the Code, applications for reconsideration were filed with the Commission by the Treasury Department on August 19, 1944, and by the Public Buildings Administration on August 21, 1944. Both applications were denied by the Commission on August 23, 1944. These two applications and the orders denying them are made a part of this petition by reference.

6. All common stock issued by Pepco has since 1922 been owned by Washington Railway and Electric Company, a public utility holding company of the District of Columbia.

7. Between 1922 and 1924, North American Company, which is a corporation organized and existing under the laws of Pennsylvania and a foreign holding corporation within the meaning of Section 43-502 of the Code, brought about the transfer into the names of persons acting on its behalf of a sufficient number of the voting shares of Washington Railway & Electric Company to enable it to control that company. Its interest in and control of Washington Railway and Electric Company was concealed from the Commission until 1925, since which time the shares have been transferred into the name of North American Company on the books of Washington Railway and Electric Company. Since 1923 North American Company, through the shares controlled by it as aforesaid, and by other

means, has controlled and directed the affairs of Washington Railway and Electric Company and Pepco.

8. From January 1, 1925 to about the middle of 1942 Pepco's outstanding common stock consisted of 60,000 shares of par value of \$100 per share, or a total par value of \$6,000,000. In the latter part of 1942 an additional 30,000 shares were issued at par, bringing the total par value of outstanding common stock to \$9,000,000. The amount paid in by the stockholders for the common stock, either in cash or the equivalent thereof in property or services, did not exceed \$5,245,000. Of the difference of \$3,755,000, \$1,000,000 of common stock was issued for the acquisition of contract rights in the unused and undeveloped Great Falls power site, and \$2,755,000 was issued in part for purported services and in part as a payment for the acquisition of other companies in excess of the cost of the acquired properties and represented intercompany profits.

9. Pepco and the Commission were engaged from 1917 to 1924 in litigation in the Supreme Court of the District of Columbia with respect to the value of Pepco's property and the rates to be charged for its services. This litigation terminated on December 31, 1924, upon the entry of a decree assented to by the parties which is commonly referred to as "the consent decree." A copy of this decree is hereto annexed and marked Appendix "A" and made a part hereof. The outstanding features of the decree are as follows: (1) it adopted \$32,500,000 as the figure on which Pepco was entitled to earn a fair return in 1925, and provided for the use of this amount, plus additions in each year to be determined as therein provided, as the "rate base" to be used in fixing rates; (2) it established 7½% on the rate base as a fair rate of return; (3) it provided that if in any year net income should exceed 7½% on the rate base, ½ the excess "shall be used in a reduction of rates" to be charged the public thereafter; that is to say, by way of example, that if the net return in any year should amount to \$100,000 above 7½% on the rate base "then the rates for the succeeding year to be charged the public shall be automatically reduced by the filing of new rate schedules to absorb \$50,000 of such excess during such year"; (4) it provided for a depreciation reserve of \$4,000,000 with accruals at established

percentages until the reserve reached a maximum of 20% of the rate base, and had a provision that interest should be accrued on the depreciation reserve at the rate of 4% per annum; (5) it contained provisions for increasing rates if the actual return fell below the basic return.

10. In each year from 1925 to 1930 inclusive, the volume of Pepco's sales increased, and the net earnings available for dividends exceeded the amount of $7\frac{1}{2}\%$ on the rate base by a substantial sum. The Commission, however, did not construe and apply the consent decree in such manner as to actually "use" any portion of the excess as a refund to rate-payers, nor require the company to "absorb" any portion of the excess of any year during the following year. It permitted all excess earnings to be retained by the company, and required only a reduction in customer's rates which was arrived at by a calculation in which the figure for gross revenue was that of the test year reduced by $\frac{1}{2}$ the excess of that year and the volume of sales and expenses were assumed to be the same as in the test year.

11. On June 8, 1931, the Commission issued its Order No. 919 which stated that "the rate of return yielded by the sliding scale is excessive and unreasonable," and reduced the basic rate of return from $7\frac{1}{2}\%$ to 7%. The order, however, codified the erroneous interpretation of the consent decree which had been adopted by the Commission from 1925 to 1930 by specifically providing that upon the occurrence of earnings in excess of 7% on the rate base "rates for the following twelve months based upon the business done in the twelve months in which such excess occurred shall be adjusted so that the gross receipt of the company shall be reduced by one-half of such excess." Since the date of this order the Commission has continued to compute rates upon the assumption that the volume of sales and the amount of expenses in each year would be the same as in the preceding test year; and has refrained from entering tentative or interim orders designed to recapture any of the excess which might occur. The net revenue of the company has in each year except 1941 (in which year there was no hearing or determination by the Commission as to the ac-

curacy of the alleged loss of \$12,000.01) been substantially in excess of the calculated net revenue.

12. During the years 1925 through 1942 income available for common stock exceeded \$66,570,000, and \$42,195,000 was paid out as dividends on common stock. The annual net earnings ranged from 43.30% to 75.13% of the par value of the entire common stock outstanding, with an average of 60.97% per year. Calculated on the basis of the \$5,245,000 actually invested in common stock, the annual earnings ranged from 94.82% to 200.81% with an average of 161.22% per year. The annual dividends actually paid on the entire outstanding common stock ranged from 14.00% to 65.00%, with an average of 38.49% per year. If dividends had been confined to the \$5,245,000 of stock above described they would have ranged from 37.41% to 173.71%, with an average of 101.33% per year. That portion of the excess earnings which was not disbursed as dividends was added to Pepco's surplus, which now stands at the figure of \$29,000,000, all derived from excessive rate payments. Tabulations of the income available for common stock and of dividends as described in this paragraph are hereto annexed and marked Appendices "B" and "C," and made a part hereof.

13. At that annual rate hearing held by the Commission in 1943, the United States of America was permitted to intervene. It urged reexamination and amendment or abandonment of the sliding scale arrangement on the ground that its operation had not resulted and could not result in rates which are just and reasonable. The Commission limited its consideration to the fixing of rates under the sliding scale arrangement; and by its Order No. 2564 of April 26, 1943 (which is incorporated herein by reference), fixed rates for that year. The net earnings under that order were again greatly in excess of the amount computed on the rate base at the prescribed rate of return. The net income for 1943 available for common stock dividends was \$3,786,418; which amounted to 42.07% on all the common stock outstanding, or 72.19% on the amount of money actually invested in common stock. The company paid out \$3,150,000 in dividends; which amounted to 35.00% of the entire out-

standing common, or 60.00% on the \$5,245,000 actually invested in common stock.

14. Since January 1, 1925, interest has been accrued on the depreciation reserve at the rate of 4% per annum as provided for in the sliding scale arrangement. During the whole period the basic rates of return fixed by the Commission have been higher than 4% and the actual returns have been higher than the basic rates. Earnings received by Pepco on the depreciation reserve in excess of 4% total approximately \$14,000,000. In the current hearings the United States contended that Section 43-315 of the Code requires that the \$14,000,000 be added to the depreciation reserve and so included in the amount to be deducted from the gross rate base in arriving at the base on which a return was to be allowed; but the Commission ruled that it was without legal power to do so.

15. On April 26, 1943, by its order No. 2565, the Commission ordered an investigation to determine whether the sliding scale arrangement should be retained, modified or abandoned, and also to cover the rate base, the rate of return, depreciation accruals, and the method of effecting rate adjustments. On January 5, 1944, the Commission, by its Order No. 2703, directed an investigation of rates under the sliding scale arrangement as it existed or as it might be modified. By the Notice of Hearing issued on January 26, 1944, the matters set forth in Orders Nos. 2565 and 2703 were consolidated for hearing. Following the hearings on these matters the Commission issued the Findings, Opinion, and Order No. 2796 which is now appealed from. It is signed by only two members of the Commission because the term of office of the third member expired after the completion of the hearings and before the entry of Order 2796. The retiring member, before the end of his term, filed his findings and an opinion. The minority report contains much material which your petitioner believes will be of value and assistance to this Court. It is not physically incorporated herein only because of its length, but a copy is filed herewith as a part of this petition and marked "Appendix D," and is incorporated herein by reference and made a part hereof as fully as though set forth herein.

16. In the course of the hearings the United States offered

to show by Exhibit 74 (marked for identification) and other evidence, (a) that North American Company has acquired control of stock of Washington Railway and Electric Company, and control of that company and of Pepco, illegally; and (b) that North American Company acquired said control and has continuously exercised it for the purpose and with the result of having rates fixed by a method and at levels grossly in excess of those which were just and reasonable; (c) that North American Company is now proposing a reorganization of Pepco under which the benefits of such excessive earnings will inure to the benefit of North American Company. The United States urged that this evidence was relevant to the question whether the rate base should include any part of the surplus, whether the surplus should enter into the computation of cost-of-capital, whether the sliding scale arrangement should be modified or rescinded, and also to the discretionary power of the Commission in fixing 1944 rates. The Commission excluded Exhibit 74 and the offered proof.

17. The United States appeals from said Findings, Opinion, and Order No. 2796 upon the following grounds and for the following reasons:

A. The Commission erred in ruling as follows with respect to the contentions of the United States that some portion or all of Pepco's surplus should be excluded from the rate base and from equity capital in computing the cost-of-capital component of the basic rate or return and that the circumstances with respect to the building up of the surplus should be given consideration in determining whether the sliding scale arrangement should be continued and taken into consideration in fixing the basic rate of return:

"The elimination of earned surplus or undistributed earnings from invested capital finds no support in reason or in law. On the contrary, it is universally recognized by both courts and regulatory authorities that undistributed earnings invested in the assets of a corporation are just as much a part of invested capital as are the dollars obtained from the sale of securities.

"What has been said with respect to the exclusion of

undistributed earnings from invested capital applies with equal force here. This Commission rejects the contention of counsel (that surplus should be excluded from common stock equity) for the Public Buildings Administration on the grounds that their adoption would be unsound, without merit, inequitable and at complete variance with established law."

B. The Commission erred in ruling that as a matter of law it is precluded from excluding any part of the surplus from the rate base or from the common stock equity and from taking the circumstances of the existence, size and sources of the surplus into consideration in any way in fixing rates or in deciding whether the sliding scale arrangement should be rescinded or modified.

C. The Commission erred in ruling as a matter of law that exclusion of surplus from the rate base and from the common stock equity was not required by Section 43-804 and other related provisions of the Code.

D. The Commission erred in finding, contrary to the requirement of the Code that it fix just and reasonable rates, that Pepco was entitled to a return in 1944 on approximately \$2,755,000 of common stock which represented no investment in used and useful property and was watered stock.

E. The Commission erred in finding, contrary to the requirement of the Code that it fix just and reasonable rates, that Pepco was entitled in 1944 to a return on the surplus of approximately \$29,000,000, as the cost of this capital to Pepco.

The result of the errors noted in this and the preceding paragraph is that the rate payers of the District of Columbia will be required to pay in 1944 approximately \$2,540,000 in excess of the just and reasonable return to Pepco, which the Commission is obligated to establish under the requirements of the Code.

F. The Commission erred in finding, contrary to the requirement of the Code that it fix just and reasonable rates, that there should be included in the rate base \$7,000,000 of property which is no longer in existence.

G. The Commission erred in ruling that Section 43-315 of the Code does not require the addition to depreciation reserve

of the actual earnings of Pepco on the reserve, but only the 4% accruals provided for in the sliding scale arrangement; the actual earnings in excess of the 4% amounting to approximately \$14,000,000.

H. The Commission erred in excluding Exhibit 74 and the offered proof of which it was a part.

I. The Commission, contrary to the requirement of the Code that it fix just and reasonable rates, adopted a rate of return and fixed the total permitted return at figures which result in rates which are as matter of law unjustly and unreasonably high.

Wherefore, the petitioner prays:

1. That the Court determine and declare that the rulings of the Commission as to surplus as set forth in the foregoing assignments of error A, B, and C are erroneous; and instruct the Commission as to the correct rules of law.

2. That the Court determine and declare that the Commission erred in ruling that just and reasonable rates can be predicated on a finding which allows the company a return on watered common stock which represented no investment in used and useful property; and instruct the Commission as to the correct rule of law.

3. That the Court determine and declare that the Commission erred in ruling that just and reasonable rates can be predicated on a finding which allows the company a return on the surplus of approximately \$29,000,000 as the cost of this capital to the company; and instruct the Commission as to the correct rule of law.

4. That the Court determine and declare that the Commission erred in ruling that just and reasonable rates can be predicated on a finding which includes in the rate base \$7,000,000 of property which is no longer in existence; and instruct the Commission as to the correct rule of law.

5. That the Court determine and declare that the Commission erred in ruling that it is not required by Section 43-315 of the Code to carry into the depreciation reserve all income actually earned by the Company on depreciation reserve amounting to approximately \$14,000,000; and instruct the Commission as to the correct rule of law.

6. That the Court determine and declare that the Commission erred in excluding Exhibit 74 and the offer of proof of which it was a part.

7. That the case be remanded to the Commission with instructions to receive such further evidence as may be offered relevant to a consideration of fixing just and reasonable rates according to the rules of law declared by this Court, and to reconsider the matter in the light of such evidence and rules of law, and to report its findings and conclusions to the Court; and with permission to the Commission to amend its Findings, Opinion, and Order No. 2796 under the authority of Section 43-709 of the Code.

8. That the Court determine and declare that Order No. 2796 is erroneous, but withhold any decree vacating said order pending a report to the Court pursuant to the provisions of Section 43-705 of the Code and the receipt by the Court of such amendment of Order 2796 as the Commission may make under the authority of Section 43-709 of the Code.

9. For such other and further relief as to this Honorable Court seems fit and proper in the premises.

By its attorneys,

FRANCIS M. SHEA,
Assistant Attorney General.
EDWARD M. CURRAN,
United States Attorney.

Of Counsel:

ARNOLD LEVY,
Special Assistant to the Attorney General.
MARVIN C. TAYLOR,
Attorney.
ALAN JOHNSTONE,
General Counsel, Federal Works Agency.
HARRY R. BOOTH,
Special Counsel,
Procurement Division, Treasury Department.

APPENDIX A

IN THE SUPREME COURT OF THE DISTRICT OF COLUMBIA

Equity Nos. 35336 and 35341

POTOMAC ELECTRIC POWER COMPANY, PLAINTIFF

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
ET AL, DEFENDANTS

Decree

The cause first above mentioned was heretofore fully argued by counsel and submitted on the 12th day of February, 1924, and was maturely considered by the court upon said argument and briefs thereafter furnished, until the 20th day of December 1924, on which date counsel announced that the parties themselves were able to reach an agreement not only settling all matters in controversy in said suit first mentioned, but in the second suit also, bringing the valuation of the plaintiff's property down to the present time, and also establishing a sliding scale as a basis upon which rates should be made in the future. On consideration whereof and upon motion, it is ordered this 31st day of December 1924, that these two causes be consolidated and hereafter heard together, and they were so heard this day, and it appearing to the court that the agreement above mentioned between the parties fixes the valuation of the property of the plaintiff used and useful in electric operations as of the 1st day of January 1925, but not including any of the property excluded by the commission from its valuation as not used or useful in electric operation, at a figure deemed fair and just by the parties and approved by the court, and therefore avoids the necessity of a specific finding by this court as to the fair value of said property as of December 31, 1916, which agreement is as follows:

1. The commission to determine fair value of property now used and useful as of January 1, 1925, of \$32,500,000 including Maryland property.

2. On the depreciation reserve as of December 31, 1924, approximately \$4,000,000, interest will be accrued on a 4 per cent basis and as an accretion to the reserve, lessening the amount of depreciation to be included as an expense of operation. Depreciation is to be based upon a modified straightline basis described in the method below:

When the depreciation reserve is below 15 per cent of the value of property indicated above, plus additions, the following rate applies: 2.3 per cent of said value.

When the depreciation reserve is 15 per cent of the said value but less than 16 per cent of said value the following rate applies: 2.1 per cent of said value.

When the depreciation reserve is 16 percent of the said value but less than 17 percent of said value the following rate applies: 1.9 percent of said value.

When the depreciation reserve is 17 percent of the said value but less than 18 percent of said value the following rate applies: 1.7 percent of said value.

When the depreciation reserve is 18 percent of the said value but less than 19 percent of said value the following rate applies: 1.5 percent of said value.

When the depreciation reserve is 19 percent of the said value but less than 20 percent of said value the following rate applies: 1.3 percent of said value.

Thereafter the accretions to the depreciation reserve shall be such as not to make the total of said reserve in excess of 20 percent of the value of such property as stated above, plus additions.

3. Rates for 1925 to be based upon a return of $7\frac{1}{2}$ percent on the above named value, namely, \$32,500,000, plus estimated cost of additions undepreciated and weighted, and shall be as shown on Schedule A hereto annexed.

4. If the rates hereafter yield more than a $7\frac{1}{2}$ percent return on \$32,500,000, plus actual cost of future additions undepre-

ciated but weighted during a period of any one year, one-half of said excess shall be used in a reduction of rates to be charged the public for electric service thereafter, thereby providing a sliding scale of rates under provisions of paragraph 18 of the Act creating the Public Utilities Commission, advantageous to the public and company alike; that is to say, by way of example, if the return for any one year should amount to \$100,000 over and above $7\frac{1}{2}$ percent on the base ascertained as aforesaid then the rates for the succeeding year to be charged the public shall be automatically reduced by the filing of new rate schedules to absorb \$50,000 of such excess during such year.

5. If the average return for any consecutive 5-year period falls below $7\frac{1}{2}$ percent on the base ascertained as aforesaid, or if the average return for any consecutive 3-year period falls below 7 percent on the base ascertained as aforesaid, or if the average return for any consecutive 12-month period falls below $6\frac{1}{2}$ percent on the base ascertained as aforesaid, the commission shall promptly increase rates so as to yield $7\frac{1}{2}$ percent on the base ascertained as aforesaid.

6. The impounded fund, with interest to December 31, 1924, less District of Columbia franchise and Federal income taxes, is to be divided equally between consumers and the company. Interest on that portion of the impounded fund which reverts to consumers to cease on December 31, 1924. Any income after January 1, 1925, on that portion of the impounded fund to be refunded to consumers shall be applied toward the cost of distribution of amounts due them.

7. The company to make refunds as promptly as possible or as the order of the court may direct.

8. Any amounts due consumers which may be unclaimed at the end of a period to be prescribed by the court shall be considered as income of the company and prorated over a term of 20 years.

And it further appearing to the court upon consideration of the record of the above causes, and the decision of the Court of Appeals of the District of Columbia made in the first case that order No. 208 of the commission fixing the valuation of

the plaintiff's property should be modified and the valuation increased, and that in view thereof order No. 223 of said commission based on said order No. 208 with the modifications thereof approved by this court, should be modified and adjusted and that the agreement between the parties hereto disposes of these matters, and upon consideration of the agreement between the parties hereto and the basis of the division of the fund impounded, the basis of which division the parties to this suit have agreed upon, as aforesaid, that the said division evidenced by said agreement is fair and reasonable, and is to the interest of the ratepayers during that period, and that all of the other provisions of said agreement are fair and reasonable, and made with the approval of the court in so far as the same are within the jurisdiction of this court in these cases, it is further adjudged, ordered, and decreed, as follows:

First. That the fund impounded by the plaintiff company under the injunction order in this cause, and representing the difference between the rates actually collected and those which were prescribed by order No. 223, and the several modifications thereof made pending the appeal therefrom, with interest thereon to December 31, 1924, amounts to \$6,388,445.54 as of that date; that from this sum there shall be deducted the franchise taxes to the District of Columbia and the Federal income taxes to the amount of \$500,000, which will accrue on that portion thereof which is to be retained by the company under this decree; that after making such deduction for taxes, the court ascertains the residue of said fund with interest thereon to December 31, 1924, to be \$5,888,445.54 as of December 31, 1924; that 50 per cent of said fund remaining after said deductions shall be retained by the plaintiff, and the residue thereof divided by its pro rata among, and paid to, the various rate payers within the District of Columbia who contributed thereto through the rates paid by them between August 1, 1917, and December 31, 1924, in the proportions in which they contributed thereto; that interest on that portion of said fund payable to the several rate payers within the said District hereunder shall be computed according to a method to be ap-

proved by the said commission but shall cease on December 31, 1924, and all interest which otherwise would accrue thereon after that date to the company, shall be applied by it toward paying the cost and expenses incident to the distribution of said fund among those entitled as herein provided; that the plaintiff shall make the refunds hereby required as promptly as may be consistent with accuracy and justice, or as the court may hereafter direct, if necessity therefor should arise; that the plaintiff company is directed to establish and publish within 30 days from this date, and to enforce, reasonable rules and regulations with which consumers shall be required to comply, to the end that the company shall be furnished as promptly and as economically as is consistent with accuracy and justice, sufficient proof of the identity of, as well as the authority to collect of all claimants, the justness of their claims, and the amounts paid by them in rates through the period above mentioned, provided that the plaintiff shall commence distributing this fund to the said rate payers within the District of Columbia within six months from this date, unless the court for cause shown shall hereafter extend such time, and all claims not properly presented and authenticated within three years from the promulgation of the rules aforesaid, shall be barred, and any amounts then remaining due rate payers who have failed to present and prove their claims within said period, and barred as aforesaid, shall thereafter be considered and accounted for by the plaintiff as income from operations, but to be prorated in accordance with agreement between the parties hereto, and hereinbefore recited.

Second. That on or before the 2nd day of January 1925, the plaintiff herein shall file new schedules and rates to be charged the public for electric service furnished within the District of Columbia, in accordance with schedule herewith attached, marked Exhibit A, forming a part of this decree, which rates shall continue to be the lawful rates for electric service within the District of Columbia to be charged by the plaintiff until modified or set aside by future orders of the commission, pursuant to law and in accordance with the agreement hereinbefore recited.

Third. These causes are ordered to be retained upon the docket of this court for such further orders as from time to time may be necessary and proper on the footing of this decree.

By the Court,

WENDELL P. STAFFORD, *Justice.*

Consent:

F. H. STEPHENS,

General Counsel, Public Utilities Commission.

JNO. S. BARBOUR,

S. R. BOWEN,

Counsel for Plaintiff.

DECEMBER 31, 1924.

EXHIBIT A—Schedule

A

*Billing rates in
effect Jan. 1, 1925*

First 120 hours use of connected load.....	7.5 cents.
Excess of 120 hours use.....	4.5 cents.
Minimum charge	75 cents.

B

First 30 hours use of connected load.....	7.5 cents.
Excess of 30 hours use.....	4 cents.
Minimum charge	\$2.00.

C

First 350 kilowatt hours.....	7.5 cents.
Next 500 kilowatt hours.....	5.5 cents.
Next 1,000 kilowatt hours.....	3.0 cents.
Excess of 1850 kilowatt hours.....	2.5 cents.
Minimum charge	75 cents.

D

First 3200 kilowatt hours.....	5 cents.
3200 to 3500 kilowatt hours.....	\$161.00.
3501 to 4565 kilowatt hours.....	4.6 cents.
4566 to 5000 kilowatt hours.....	\$210.00.
5001 to 7500 kilowatt hours.....	4.2 cents.
7501 to 8333 kilowatt hours.....	\$315.00.
8334 to 11066 kilowatt hours.....	3.75 cents.
11067 to 12500 kilowatt hours.....	\$415.00.
Excess of 12500 kilowatt hours.....	2.5 cents.
Minimum charge	\$105.00.

E

Fixed charges:

First 20 kilowatts of demand.....	\$2.75.
Next 30 kilowatts of demand.....	\$2.25.
Next 50 kilowatts of demand.....	\$2.00.
Excess of 100 kilowatts of demand.....	\$1.75.

Energy Charges:

First 250 kilowatt hours.....	5.5 cents.
Next 500 kilowatt hours.....	4.5 cents.
Next 1000 kilowatt hours.....	3.5 cents.
Next 12000 kilowatt hours.....	2.2 cents.
Next 25000 kilowatt hours.....	1.3 cents.
Next 150000 kilowatt hours.....	1.2 cents.
Excess of 188750 kilowatt hours.....	1.1 cents.
Minimum charge	\$55.00.

F

Billing rates in effect Jan. 1, 1925

First 1000 kilowatt hours.....	5.5 cents.
Next 500 kilowatt hours.....	4.5 cents.
Next 500 kilowatt hours.....	3.5 cents.
Excess of 2000 kilowatt hours.....	3 cents.
Minimum charge.....	\$1.00.

G

First 50 hours use of demand.....	7.5 cents.
Excess of 50 hours use.....	3 cents.
Minimum charge.....	\$25.00.

H

First 10 kilowatt hours.....	7.5 cents.
Excess of 10 kilowatt hours.....	3.5 cents.
Minimum charge.....	\$1.00.

APPENDIX B

POTOMAC ELECTRIC POWER COMPANY'S

Earnings on Common Stock

Year	Income available for common stock	% earnings on par value ¹	% earnings on actual investment in common stock ²
1925.....	\$2,598,289.50	43.30	115.73
1926.....	2,799,940.62	46.66	124.71
1927.....	2,980,336.59	49.67	132.74
1928.....	3,506,743.91	58.44	156.20
1929.....	3,899,687.56	64.99	173.70
1930.....	4,372,013.70	72.86	194.74
1931.....	4,202,255.29	70.03	187.18
1932.....	4,100,602.51	68.34	182.62
1933.....	3,996,359.64	66.60	178.00
1934.....	3,637,784.07	60.63	162.03
1935.....	3,630,460.99	60.50	161.71
1936.....	4,093,619.98	68.22	182.34
1937.....	4,508,267.78	75.13	200.81
1938.....	3,710,454.28	61.84	165.27
1939.....	3,851,566.32	64.12	171.60
1940.....	3,575,306.01	59.58	159.25
1941.....	3,560,007.46	59.33	158.57
1942.....	3,551,074.81	³ 47.34	⁴ 94.82
Total.....	66,574,771.02	1,097.58	2,902.02
Average.....	3,698,598.39	60.97	161.22

¹ \$6,000,000 from 1925 through June 1942 and \$9,000,000 from July 1942 through December 31, 1942.² \$2,245,000 from 1925 through June 1942 and \$5,245,000 from July 1942 through December 31, 1942.³ Based on an average of \$7,500,000 par value for the year 1942.⁴ Based on an average investment of \$3,745,000 for the year 1942.

APPENDIX C

POTOMAC ELECTRIC POWER COMPANY'S

Distribution of Dividends on Common Stock

Year	Common stock dividends	% dividends on par value ¹	% dividends on actual investment in common stock ²
1925.....	\$840,000.00	14.00	37.41
1926.....	960,000.00	16.00	42.76
1927.....	1,080,000.00	18.00	48.10
1928.....	1,200,000.00	20.00	53.45
1929.....	1,320,000.00	22.00	58.79
1930.....	1,440,000.00	24.00	64.14
1931.....	1,560,000.00	26.00	69.48
1932.....	1,680,000.00	28.00	74.83
1933.....	1,800,000.00	30.00	80.17
1934.....	2,280,000.00	38.00	101.55
1935.....	2,550,000.00	42.50	113.58
1936.....	3,600,000.00	60.00	160.35
1937.....	3,900,000.00	65.00	173.71
1938.....	3,900,000.00	65.00	173.71
1939.....	3,900,000.00	65.00	173.71
1940.....	3,540,000.00	59.00	157.68
1941.....	3,540,000.00	59.00	157.68
1942.....	3,105,000.00	³ 41.40	⁴ 82.91
Total.....	42,195,000.00	692.90	1,824.01
Average.....	2,344,166.66	38.49	101.33

¹ \$6,000,000 from 1925 through June 1942 and \$9,000,000 from July 1942 through December 31, 1942.

² \$2,245,000 from 1925 through June 1942 and \$5,245,000 from July 1942 through December 31, 1942.

³ Based on an average of \$7,500,000 par value for the year 1942.

⁴ Based on an average investment of \$3,745,000 for the year 1942.

APPENDIX D

Public Utilities Commission of the District of Columbia

**IN THE MATTER OF POTOMAC ELECTRIC POWER COMPANY SLID-
ING SCALE ARRANGEMENT AND INVESTIGATION OF RATES,
TOLLS, CHARGES, RULES, REGULATIONS, AND CONDITIONS
OF SERVICE**

P. U. C. No. 3362—Formal Case No. 335

P. U. C. No. 3377—Formal Case No. 338

**SEPARATE FINDINGS AND OPINION OF COMMISSIONER
HANKIN**

(Filed June 23, 1944)

Public Utilities Commission of the District of Columbia

P. U. C. No. —

June 23, 1944

IN THE MATTER OF POTOMAC ELECTRIC POWER COMPANY SLID-
ING SCALE ARRANGEMENT AND INVESTIGATION OF RATES,
TOLLS, CHARGES, RULES, REGULATIONS, AND CONDITIONS
OF SERVICE

Formal Case No. 335

Formal Case No. 338

To the Executive Secretary:

Attached hereto are my separate findings and opinion in
the above-entitled matter, which you will please file as part
of the record in the case.

GREGORY HANKIN,
Commissioner.

CC:

JAMES H. FLANAGAN, *Chairman.*

C. W. KUTZ, *Commissioner.*

JAMES A. LAUDERDALE, *People's Counsel.*

THURMAN HILL, *Procurement Division, Treasury De-
partment.*

ALAN JOHNSTONE, *General Counsel, Federal Works
Agency.*

BOWEN & KELLY AND WILLIAM K. LAWS, *Counsel, Po-
tomac Electric Power Co.*

Public Utilities Commission of the District of Columbia

Formal Cases Nos. 335 and 338

IN THE MATTER OF POTOMAC ELECTRIC POWER COMPANY SLIDING SCALE ARRANGEMENT AND INVESTIGATION OF RATES, TOLLS, CHARGES, RULES, REGULATIONS AND CONDITIONS OF SERVICE.

Commissioner Hankin (Separate Findings and Opinion)*:

FINDINGS

Upon consideration of the orders of investigation, the notice of hearing, the transcript of testimony and the arguments presented, I find that:

1. The Potomac Electric Power Company, hereinafter referred to as the "COMPANY" or "PEPco.", is the sole public utility engaged in the business of furnishing and selling electric energy to the people and to the United States Government in the District of Columbia. Since 1925 PEPco's rates have been determined annually in accordance with a sliding scale arrangement.

2. The Federation of Citizen's Associations consists of 67 member bodies, each of which is an association of citizens residing in a geographical part of the District of Columbia. The members of the various associations are consumers of electric en-

* The hearing in this case began on February 28, 1944, and continued with a number of interruptions until May 9, 1944. It was adjourned subject to call, because, as is customary in such cases, the Commission first arrives at its conclusions and then directs the Company to introduce evidence as to rate schedules predicated upon a given reduction in gross revenue. For all intents and purposes, therefore, the hearing is completed.

Since my term of office expires on June 30, 1944, I deem it my obligation to file for the record my separate findings and opinion, without waiting for the findings and opinion of the other Commissioners.

ergy sold by PEPCo. The Federation entered an appearance in this case and filed a resolution to the effect that its members favored the continuation of the method heretofore pursued in determining PEPCo.'s rates and charges, but it produced no evidence in support of this method nor in support of the reasonableness of the rates.

3. The United States of America is the largest consumer of electric energy in the District of Columbia. It intervened in this case through two separate agencies, the Procurement Division of the Treasury Department and the Federal Works Agency, each alleging that the rates determined in accordance with the sliding scale arrangement have been and are unjust and unreasonable, and each of them requesting that this method of rate determination be either abandoned or modified to the end that the rates determined might be just, reasonable and non-discriminatory.

4. The sliding scale method of rate regulation is a rate-making device providing for a plan of annual rate adjustments to the end that the return to the Company and the rates charged to the public shall be reasonable, on the theory that where the charges for the units of service are otherwise worth their price, the reasonableness of the return to the Company also measures the reasonableness of the charges to the public.

5. The sliding scale method, if properly applied, results in a greater degree of fairness both to the utility and the public than the traditional method of rate regulation through valuations or other sporadic rate determinations.

6. A sliding scale method may, but need not, depend on the consent of the utility regulated, so long as the latter is allowed a fair return.

7. The sliding scale method of rate regulation embodied in the Consent Decree of December 31, 1924, was designed to provide for annual rate adjustments which would be advantageous to the utility and to the public. The provision in the Decree as to depreciation, however, was not in conformity with the provisions in the Law creating the Public Utilities Commission. The provision as to the rate base is now outmoded by more recent developments in rate making. Its provisions as to rate adjustments have not been applied. In addition, the history

of the Company as an integral part of a foreign holding company system, the history of the rate determinations under the sliding scale arrangement and the provisions of law against capitalization of surplus have rendered a property rate base inapplicable and therefore also have rendered the sliding scale method embodied in the Consent Decree inapplicable.

8. The sliding scale arrangement as applied is fundamentally different from the method embodied in the Consent Decree of 1924. It is characterized by excessive earnings to the Company, hence in unjust and unreasonable rates to the consumers. It has been kept in operation through the use of many false and misleading concepts and through words and phrases of advertising appeal, leading the public into thinking that, because the charges per unit of service were lower here than elsewhere, therefore, the rates were just and reasonable.

9. Even with the sliding scale arrangement as applied, the rates and charges per unit of service in the District of Columbia are lower than in most jurisdictions where the sliding scale method of rate determination is not used. This demonstrates the superiority of the sliding scale method over the traditional methods of rate regulation, but is no indication that the method employed is as advantageous to the public as it is entitled to have under the facts and law of this case.

10. PEPCo. is entitled to a fair return on its investment in the property used and useful in the service, and the consumer must pay rates which will yield such a return.

(a) The investment in property in its present state of depreciation, plus an allowance for materials and supplies, is \$74,000,000.

(b) This, however, includes an earned surplus which, adjusted, is in the neighborhood of \$27,000,000 and which does not constitute an investment by the investors but by the consumers. The Company is not entitled to earnings upon these past earnings for two reasons: first, because the allowance of a return thereon would constitute a circumvention of Paragraph 75 of the Law Creating the Public Utilities Commission, accomplishing by indirection the same result as the issuance of stock dividends by a public utility, which is forbidden by the statute; and, second, because the earned surplus is the

result of excessive earnings made possible by irregularities of such magnitude that the earned surplus must be regarded as involuntary contributions to plant on the part of the consumers.

(c) Excluding such earned surplus, the rate base would be \$47,000,000. A fair rate of return applied to such rate base would not yield a return sufficient to support the present capital structure of the Company and to attract new capital.

(d) By its conduct in the past twenty years, including the distribution of fabulous dividends of as much as 65 percent per year on the par value of the common stock (and of as much as 173 percent per year on the actual investment in common stock), the Company has rendered impossible the use of a property rate base consistently with the law.

11. PEPCo. is entitled to a return (over and above its operating expenses, depreciation and taxes) which will be sufficient to pay interest on the bonds, dividends on the preferred stock, *reasonable* dividends on the common stock and leave "something" for surplus.

(a) On this basis, it is necessary to consider only the capital honestly and prudently invested in the corporation. This, together with an allowance for working capital and customers' deposits, on which the Company pays interest, totals some \$58,000,000.

(b) Considering that the cost of bond money to the Company is 3.008 percent, that the cost of preferred stock money is 5.86 percent and that 10 percent would be sufficient as earnings on the common stock money actually received by the Company, the over-all cost of money to the Company is 4 percent, and this is the proper rate of return which should be allowed.

(c) Applying this rate of return to the prudent investment rate base, the allowable return should be \$2,320,000.

12. On the basis of the Company's experience in 1943, the allowance of a return of \$2,320,000 calls for an initial reduction in gross revenue of at least \$5,000,000.

13. Thereafter the rates should be adjusted annually in accordance with the following sliding scale method:

(a) The common stock of the Company should be reduced to \$5,245,000, and dividends on this common stock money actually invested should be limited to 7½% per year.

(b) A stabilization fund in an amount equal to one year's return should be set aside out of surplus for the purpose of meeting any deficiency in earnings necessary to pay interest and dividends.

(c) If the return earned in any one year exceeds the allowed return, one-half of such excess should be treated as having been earned for the following year, and the rates should be so reduced as to yield as nearly as practicable the allowed return less one-half of the excess in the preceding year.

(d) The other half of the excess earnings, plus the excess in the allowed return over and above that necessary to pay interest and dividends, should be available, subject to the direction of the Commission, for retirement of outstanding obligations, for depreciation expense, for repairs and maintenance and for such other purposes as, in the judgment of the Commission, would be of benefit to the consumers.

(e) If the return in any one year falls below the allowed return to the extent that it is necessary to draw materially on the stabilization fund, and if such deficiency in earnings cannot conveniently be made up by drawing upon past excess earnings or earned surplus, then the rates should be so increased as to yield the allowed return.

(f) The rate base, the rate of return and the allowed return should be redetermined whenever there is a substantial change in the Company's outstanding securities.

OPINION

The facts and reasons in support of the above findings are contained in the following opinion.

I. Nature of the proceeding

In the 1943 electric rate hearing,¹ the United States of America and the Director of Economic Stabilization, who had intervened, maintained that the rates determined under the sliding scale arrangement with PEPCo. were not just and reasonable, and they insisted that rates be fixed which would be fair and reasonable, irrespective of any arrangement, agreement or understanding between the Commission and the utility. The

¹ In *Re Potomac Electric Power Co.*, Formal Case No. 326.

Commission overruled these contentions and limited the presentation of evidence to that which was said to fall within the framework of the sliding scale arrangement (including the customary computations made under that arrangement). A rate reduction was ordered, which was not attributable to the sliding scale arrangement, but largely to the fact that income taxes were allowed as revenue deductions only to the extent of 31% of the net taxable income, and no excess profits taxes were allowed as revenue deductions.² Thus, Order No. 2564³ was issued on April 26, 1943, closing that proceeding, which, in a sense, must be regarded as the forerunner of the present case.

For a full appreciation of this case, it is important to know (A) the orders of investigation, (B) the preparation of the evidence, (C) the parties and their respective positions, and (D) the general plan of the hearing.

A. The orders of investigation

Simultaneously with the issuance of Order No. 2564, the Commission also issued Order No. 2565, the substance of which was to institute an investigation to determine whether the sliding scale arrangement with PEPCo. should be retained, modified or abandoned, and to reexamine the basic elements of the sliding scale arrangement, to wit: the rate base, the rate of return, the depreciation accruals and the method of effecting rate adjustments. I concurred in this order of investigation with the reservation that, whatever may be the result, any arrangement adopted should be regarded merely as a *method* for determining just and reasonable rates required by law; that the method might serve as a means for eliminating unnecessary controversies during the rate proceedings; but that it should not, in any circumstances, be regarded as a contract binding either on the Commission or on the utility. I took the view that the former was at all times under a duty to see that the rates are just and reasonable, and that the latter was at all times entitled to be free from confiscation.

On January 5, 1944, the Commission also issued an order of

² Tr. p. 247.

³ Exh. 11.

investigation⁴ to determine the rates under the sliding scale arrangement. I dissented from this order for the reason that there was nothing of substance to be investigated. The first order of investigation (No. 2565) naturally covered all that could be done under the second order. However, the computations made under the sliding scale arrangement serve a useful purpose in this case, as will appear later. By the notice, dated January 26, 1944, the two orders of investigation were consolidated for hearing.

B. Preparation and presentation of evidence

As is customary in proceedings of this character, the Commission's Chief Accountant and Chief Engineer were directed to prepare exhibits to be presented as evidence at the hearing. Exhibits were prepared by the Chief Accountant pursuant to a plan submitted by him to the Commission. The Commission took no action on the plan submitted,⁵ but the exhibits prepared by him, or under his supervision, were discussed with the two civilian commissioners. The Chief Engineer also prepared exhibits, some of which, I am informed by him, he had discussed with the Chairman, but not with the other Commissioners. The Commission's exhibits, as also the testimony in connection therewith, were in effect the exhibits and testimony of the Commissioners.

In view of this customary administrative procedure, a question at times arises, What should be the method to be pursued in case one of the Commissioners disagrees with the others as to the significance of some of the evidence thus prepared or deems it necessary to have other or additional evidence in the record? It would appear that parallel procedure requires that the members of the staff prepare such evidence also, and that it be introduced at the hearings in the same manner, or that the Commissioner prepare such evidence himself in the form of exhibits, explain their significance and have them incorporated in the record.⁶ His explanation of the evidence, like the evidence

⁴ Order No. 2703.

⁵ Tr. pp. 42-3, 67, 463.

⁶ See Tr. pp. 88-92, 508-558, 619-632. See, also, p. 3950, where the Chairman makes a distinction between giving information off the record and "testifying" on the record.

introduced at the direction of the majority of the Commission, is not subject to the objection that the Commissioners are acting both as witnesses and as judges. Such an objection is based upon an erroneous analogy to judicial proceedings where it is neither customary nor proper for a judge to introduce his own evidence in a case, except as to matters of which a court may take judicial notice. Rate making, however, is essentially a legislative process.⁷ While the procedure adopted is said to be quasi-judicial, the administrative agency is not limited by the same rules as the courts.⁸ In an administrative proceeding legislative in character, it is perfectly proper for members of the regulatory agency to introduce evidence by way of exhibits or otherwise, provided that in making such evidence a part of the record they do not deprive any of the parties of an opportunity to rebut such evidence,⁹ or introduce evidence of their own, and provided further that the determination of the facts is based on the weight of the evidence in the entire record. Of course, even in a judicial proceeding it is proper for a judge to make part of the record his inferences from facts testified to by witnesses.

Impropriety or unfairness results not from the fact that commissioners seek out facts which they make part of the record, available for rebuttal, but from failing to consider evidence that had been introduced; from considering facts which are not in the record,¹⁰ from giving a one-sided picture of a complex fact; from excluding evidence which might serve to diminish the effectiveness of the facts brought out by the commissioners, directly or through members of the staff; from arriving at conclusions unsupported by weight of the evidence; and from failing to disclose the fact that the very members of the staff who prepare the evidence also participate in the writing of the final orders or decisions.

In addition to the testimony thus prepared and presented by the staff, the Commission also introduced as its witness Mr. Charles W. Smith, Chief Accountant of the Federal Power Com-

⁷ *Prentis v. Atlantic Coast Line Railroad Co.*, 211 U. S. 210, 226.

⁸ *Comp. United States v. Morgan*, 313 U. S. 409.

⁹ *Morgan v. United States*, 304 U. S. 1.

¹⁰ *The Chicago Junction Case*, 264 U. S. 258, 263; *I. C. C. v. L. & N. R. Co.*, 227 U. S. 88, 93.

mission. He presented a thorough analysis of the problems of depreciation in relation to rate making. Whether one agrees or disagrees with any or all the conclusions reached by him, the great value of his evidence, in a proceeding of this character, cannot be doubted.

The intervenor introduced as its witness Dr. James C. Bonbright, Chairman of the New York State Power Authority and Professor of Finance at Columbia University, who is one of the outstanding authorities on public utility matters. Here, also, whether one agrees or disagrees with any or all of his conclusions there can be no doubt that his evidence gave the Commission much food for thought and consideration. The testimony of Dr. Bonbright was supplemented by that of Mr. Fred Kleinman, Chief Accountant of the Illinois Commerce Commission. The value of his testimony lay in his explanation of the concepts used in rate regulation. Commissions, like other bodies, in rate making as in other tasks, fall into the practice of using words whose meanings are either obscured or lost entirely. In the reexamination of any method of rate regulation, it is highly important that one engage in clear thinking rather than in use of words of doubtful meaning.

The evidence was also supplemented by Mr. Charles W. Smith, as witness for the intervener, when he related his former testimony on depreciation to the rate base, the allowable return and the rate reduction to which the consumers, according to him, were entitled.

The intervener also introduced the testimony of Mr. Arthur E. Lundvall, Chief Accountant of the Federal Trade Commission, who, together with his staff, made a study¹¹ of the financial history and operations of the Potomac Electric Power Company from 1896 through 1943. The section in this study, entitled "Control of the Potomac Electric Power Company" led to more complete evidence¹² which, though excluded, nevertheless plays an important part in this case.

The Company introduced evidence through members of its staff as to the return which should be allowed under the sliding scale arrangement, the necessary allowances for deprecia-

¹¹ Exh. 29.

¹² Exh. 74.

tion, and the return which the Company must have in order to maintain its present financial standing. It also had as its witnesses two expert engineers who testified as to what the Company's return should be, if the sliding scale arrangement were not continued. The President of the Company testified as to how the sliding scale arrangement was adopted and as to the benefits which flowed from it to the consumers. He also strongly urged that the adjustments in rates should be determined through conferences, rather than through formal hearings.

None of the witnesses testified with absolute objectivity. While they all testified as to what they deemed to be the facts, they also assumed as a major premise the interest either of the consumer or of the Company, either as to all or only some of the phases of this problem. In a case of this character, therefore, the important question is not who testified, but what was the evidence, though in the analysis of the evidence one must also have clearly in mind who are the parties and what are their respective positions.

C. The parties and their respective positions

The Company, the Federation of Citizens' Associations, and the United States appeared as parties in this proceeding.

(1) *The Company*.—The history of PEPCo. may be divided into three periods of approximately twenty years each.

(a) *First period*.—The first twenty years may be characterized as the period of infancy. With reference to this period, Dr. Irvin Bussing writes as follows: ¹³

The company as we know it today, is the outgrowth of organizing activities which were carried on by professional promoters in the early days of electrical development. Well versed in financial legerdemain and the processes by which that legal entity, the corporation, may be manipulated and rendered subservient to the private ends of those who call it into being, these men created, dissolved, bought, sold, and bartered during a

¹³ Bussing: Public Utility Regulation and the So-called Sliding Scale, pp. 99-100.

period of twenty years, the corporate antecedents of the present company.

The facts pertaining to this period are sufficiently covered in the findings and opinion of this Commission accompanying the valuation order of May 2, 1917.¹⁴ It is sufficient to note here that by 1902 PEPCo. became the only electric company in the District of Columbia. It had an outstanding capital stock of \$5,000,000, of which not more than \$2,245,000 had been issued for cash or for the equivalent thereof in property or services.¹⁵

(b) *Second period.*—The second twenty-year period may be characterized as the period of control by a local holding company. For the purposes of this case, PEPCo. must be treated not as a separate and distinct entity, but as part of a holding-company system.

About the year 1899, the promoters of PEPCo. also formed a holding company to own securities in a number of street and interurban railroads and in the two electric companies then in existence in the District.¹⁶ The holding company soon changed its name to Washington Railway and Electric Company (hereinafter referred to as WRECo.). Three significant events took place during this period. (i) In May 1912, WRECo. entered into an agreement¹⁷ with PEPCo., whereby, in consideration of the promise of the former to convey "an undivided two-thirds interest" in the Great Falls power site within a year, PEPCo. conveyed 10,000 shares of common stock to WRECo. at the time of the execution of the agreement. It was further agreed that WRECo. would convey its shares of stock in the Great Falls Power Company (a 100% affiliate which owned the power site) to a trustee as security for the faithful performance of the contract, and PEPCo. reserved the right to rescind the contract upon failure of WRECo. to convey the undivided two-thirds interest, to return the shares in Great Falls Power Company and to require WRECo. to return the 10,000 shares of common stock with all the dividends received thereon.

¹⁴ Order No. 208.

¹⁵ Exh. 41, Tr. pp. 1632-53.

¹⁶ Since then, PEPCo. acquired the other electric company, and WRECo. owned 100% of the common stock of PEPCo.

¹⁷ Exh. 44.

WRECo. did not perform its part of the agreement within the time specified, and the two corporations agreed to extend this contract for another year. These extensions continued from year to year, by agreement signed by the Presidents, Vice Presidents or Secretaries of the Companies, sometimes the same person signing the contract for both corporations.¹⁸ In 1936, the original contract was amended whereby WRECo. promised to convey a three-thirds interest in the power site, which has not yet been conveyed, but there was no longer any provision whereby PEPCo. might "require" WRECo. to return the 10,000 shares of common stock and all dividends received thereon. The 1917 valuation excluded PEPCo.'s interest in the power site from property used and useful in the public service, and it has since then been carried on the books as non-operating property. But throughout the years since 1912, PEPCo. paid out over \$8,500,000 in dividends, which were earned from operating property;¹⁹ in other words, from payments made by the consumers.

(ii) The second significant event during the period was that the Public Utilities Commission was created by an Act of Congress,²⁰ and in 1917 a valuation was made of the Company's properties. This valuation was contested by litigation in court until 1924, when it was settled by the Consent Decree which instituted the sliding scale arrangement.

(iii) The third significant event was that in 1913, at the time of the passage of the Law Creating the Public Utilities

¹⁸ Exh. 44C. This was indeed a strange contract to be entered into by public utilities. If full effect were given to the corporate fictions, WRECo. really had no part of the power site to convey. If the corporate fictions are disregarded, then the 10,000 shares of stock are nothing but pieces of paper giving the appearance that PEPCo.'s capital has increased by \$1,000,000.

¹⁹ Exh. 29, p. 26. It is argued that the ratepayers were in no way affected by this transaction, because all of PEPCo.'s common stock was owned by WRECo., and the latter would have received all of the dividends anyway. Yet, if in the payment of just and reasonable rates, the ratepayers must support the capital structure of a utility, they are definitely affected when they support a common stock capital of \$6,000,000, when the common stock capital is \$5,000,000, and when the actual investment in common stock is at most \$2,245,000 (Exh. 41, Tr. pp. 1633-53, 1796-9).

²⁰ 37 Stat. 974.

Commission, Congress also enacted the Anti-merger Law,²¹ which was really an anti-holding company act for the utilities of the District of Columbia. This law made it unlawful for any foreign holding corporation, directly or indirectly, to own, control, or hold or vote stock or bonds of any public utility in the District of Columbia, "except as heretofore or hereafter expressly authorized by Congress." It also made it unlawful for any public utility in the District of Columbia to sell or transfer any portion of its stock or bonds to a holding corporation, "unless heretofore or hereafter expressly authorized by Congress so to do"; and every contract, transfer, agreement to transfer, etc. of any stock or bond without such authorization was made "utterly void and of no effect."

(c) *Third period.*—This introduces the third twenty-year period, for in this period PEPCo. became part of a foreign holding company system.²² Just as for the second period, PEPCo. must be regarded as part of a local holding company, so in this

²¹ This Law provides in part as follows:

"* * * it shall be unlawful for any foreign public utility corporation, or for any foreign or local holding corporation, or for any local street railroad corporation, gas corporation, electric corporation, telephone corporation, telegraph corporation, or any other local public utility corporation, directly or indirectly, to own, control, or hold or vote stock or bonds of any public utility corporation organized under any general incorporation law or special Act of the United States or authorized under any law of the United States to do business in the District of Columbia, except as heretofore or hereafter expressly authorized by Congress; and it shall be unlawful for any public utility corporation organized or authorized as aforesaid to sell or transfer any portion of its stock or bonds to any other public utility corporation or holding corporation whatsoever, unless heretofore or hereafter expressly authorized by Congress so to do; and every contract, transfer, agreement to transfer, or assignment by any said public utility corporation organized or authorized as aforesaid of any portion of its stock or bonds without such authority shall be utterly void and of no effect."

²² Most of the facts pertaining to this period are taken from Exh. 74, Sch. 1, a report submitted by the Securities and Exchange Commission entitled: "Past and Present Relations, Direct and Indirect, between the Northern American Company and Washington Railway and Electric Company, Potomac Electric Power Company and Capital Transit Company." The majority of the Commission ruled that the exhibit was not admissible in evidence (Tr. p. 4045). For the reasons why I think the exhibit is proper evidence in this case, see Tr. pp. 4045-4054.

period it must be viewed in the light of its being an integral part of a foreign holding company system, for the unlawful corporate setup, coupled with the huge profits of one of the corporations (PEPCo.), distributed as dividends to the top holding company, has a definite bearing on the question of what should be PEPCo's rate base, and how great a burden must be borne by the consumers in support of the utility's corporate structure, as will appear later.

In 1922, WRECo., which owned 100% of the common stock of PEPCo., had outstanding 65,000 shares of common stock, with a par value of \$100 each. Of this stock, 27,500 shares were held by a Noteholders' Protective Committee, and holding companies became interested in the acquisition of this stock. Toward the end of October of that year, the Executive Committee of the North American Company, a foreign holding corporation, (hereinafter referred to as North American), formed a syndicate, consisting mainly of its officers, to acquire this stock. The 27,500 shares were thus purchased in November 1922, and 890 shares in 1923. In the following year and in 1925 North American purchased 20,093 shares directly, but in the names of several of its employees. The certificates, however, were sent to the Treasurer of North American.

About this time there was agitation for a merger of the street railway operations in the District of Columbia. In view of the provisions of the Anti-merger Law, the Commission could not even entertain a proposal for a merger, since that would be in violation of law. In March 1925, therefore, Congress passed an Act ²³ in the first section of which it authorized and empowered

²³ Act of March 4, 1925, the pertinent parts of which are as follows:

"* * * That any or all of the street railway companies operating in the District of Columbia, be, and they are hereby, authorized and empowered to merge or consolidate, either by purchase or lease by one company of the properties, and/or stock or securities of any of the others, or by the formation of a new corporation to acquire the properties, and/or stocks or securities and to succeed to the powers and obligations of each or any of said companies under such terms and conditions as may be agreed upon by vote of a majority in amount of the stock of the respective corporation and as may be approved by the Public Utilities Commission of the District of Columbia: Provided, That no merger of said companies shall be finally consummated until the same is approved by a joint resolution of Congress * * *.

"SEC. 2. The inhibitions and restrictions contained in section 11 of the Act of March 4, 1913 (commonly known as the antimerger law, Public Num-

the street railway companies in the District to merge or consolidate upon such conditions, among others, as might be approved by the Public Utilities Commission, with the further limitation, however, that no merger should be consummated until it was approved by a Joint Resolution of Congress. By Section 2 of the same Act, the restrictions of the Anti-merger Law were removed "so far, and only so far, as they affect the acquisition by any corporation of the stocks or bonds of any corporations referred to in the first section." North American immediately interpreted this statute as legalizing all it had done,²⁴ and from then on the acquisitions of stock in WRECo. were carried on in the light of day.

bered 435. Thirty-seventh Statutes at Large, page 1006), be, and the same are hereby, removed so far, and only so far, as they affect the acquisition by any corporation of the stocks or bonds of any of the corporations referred to in the foregoing section."

²⁴ Apparently, it took the position that the words "any corporation" in Section 2 of the Act meant not only "any street railway companies," as used in Section 1 of the Act, but also "any foreign holding corporation"; that the removal of the restrictions applied not only to street railways, but also to direct or indirect ownership, control and voting of stock of the "electric corporation" (PEPCo.), and, finally, that the inhibitions and restrictions were removed not only from the time when Congress approved the merger by Joint Resolution, but also for all the years which preceded the supposed removal of the restrictions.

Such an interpretation is not warranted by the application of any known rules of statutory construction. Suffice it to say that the Act of March 4, 1925, was legislation by way of an exception to an established legislative policy, and, therefore, must be strictly construed. In this view, neither the purpose of the legislation, as reflected in its history, nor its meaning, as reflected in its language, bear out such an interpretation of the statute. However, it is not necessary to go into all these ramifications. The Act of March 4, 1925, did not, in its operation and effect, either create or increase any substantive rights. It merely authorized and empowered certain utilities to enter into negotiations or agreements, subject to approval by the Public Utilities Commission. Under this Act, neither the agreements entered into by the companies, nor the approval of the Public Utilities Commission, became operative until approved by Congress in a Joint Resolution. Evidently, had Congress never passed such a resolution, the legal position of North American would have remained unchanged by anything contained in the 1925 Act. Therefore, if there was any change in its legal position it must be found in the Joint Resolution.

Congress passed such a resolution on January 14, 1933, as Public Resolution No. 74, 72nd Congress, "to authorize the merger of street railway corporations operated in the District of Columbia, and for other purposes." This resolution recited the Unification Agreement between the Washington

The syndicate, which, according to its agreement, was to terminate on December 31, 1923, was dissolved on May 3, 1925. and its holdings, 28,390 shares, were transferred to North American at a recorded cost of \$1,960,295. Later in the same year the shares issued in the names of various employees of North American were transferred to the North American Company itself. Thus the initial acquisition of North American in WRECo., which took place in 1922 through 1925, resulted in a net holding of 48,740 shares, and the recorded costs totalled \$4,275,711, or \$87.72 per share.

The second part of the acquisition covered the years 1927, 1928 and part of 1929. In 1927, North American acquired 1,453 shares at a recorded cost of \$625,977, or on an average of \$430.82 per share. In 1928, it acquired 5,454 $\frac{3}{4}$ shares at the recorded cost of \$2,983,604, or \$546.97 per share. In 1929, through a wholly owned subsidiary, it acquired 2,967 shares at a recorded cost of \$2,766,929, or at \$932.57 per share.²⁵ By the end of this period, North American held 58,613 $\frac{3}{4}$ shares out of a total of 65,000 shares, or 90.17 percent.

From 1929 through 1933, the third period, the acquisitions were in exchange for North American stock, although some shares were purchased for cash. By the end of this period,

Railway and Electric Company, The Capital Traction Company and the Washington Rapid Transit Company, and ratified and approved the same, subject to the conditions therein stated. By this resolution, Congress expressly authorized acquisitions of stocks and bonds of the newly created Capital Transit Company by these street railway corporations. To that extent, an express authorization was made, pursuant to the Anti-merger Law, but the Joint Resolution left the Anti-merger Law undisturbed, which, by its language, contained certain inhibitions and restrictions, "except as heretofore or hereafter expressly authorized by Congress." Not a word is contained either in the Unification Agreement or in the Joint Resolution about any other corporations, certainly not about North American, which would permit it to own, control or hold or vote any stocks or bonds of any public utility corporation in the District of Columbia.

²⁵ One may indeed wonder at this point why North American acquired this stock through a subsidiary, why did it pay such high prices, from whom did it acquire the stock, who got the money, and why? Of course, it is possible that the only reason for such sudden phenomenal increase in the price of WRECo. stock was that its subsidiary, PEPCo., became a "gold mine" on account of the sliding scale arrangement entered into in 1924, and the manner in which it was applied, of which more will appear later.

North American held 62,197 shares or approximately 96% of WRECo. common stock,²⁶ at a recorded total cost of approximately \$12,000,000.

Since then, and after the enactment of the Public Utility Holding Company Act in 1935, North American has made attempts to recapitalize its holdings in WRECo. so as to be able to dispose of them at a huge profit in addition to the profits it had already received.²⁷ The first plan was that North American's holdings of 62,197 shares were to be broken up into participating shares of 25 to one, to be sold at \$30 per participating share, or \$750 per full share, or for a total of approximately \$46,600,000. Considering that the total recorded cost of the stock to North American was about \$12,000,000, this plan would have permitted North American to divest itself of its holdings at an additional profit of \$34,600,000. Pursuant to this plan, WRECo. filed a registration statement with the S. E. C., but apparently the public reaction was so adverse that the registration statement was withdrawn.

The second attempt was by way of "avoiding" the registration requirements. In 1939, North American deposited 12,000 of the shares with the Bankers Trust Company under a trust agreement whereby the latter would issue "certificates of beneficial interest" at the rate of 40 units per share. North Ameri-

²⁶ During the years 1924-1929, North American also acquired large blocks of WRECo's. preferred stock, which it sold in the years 1931 and 1941. It also acquired stock in the Washington Rapid Transit Company and in The Capital Traction Company, predecessors of the Capital Transit Company. Through the merger of the street railway companies, WRECo. acquired 50% of the common stock of the Capital Transit Company, and North American acquired 1¼% directly, thus giving the latter a 51¼% control of the Capital Transit Company.

²⁷ From 1922 through 1942, North American's realized gains from its holdings in the local utilities were as follows:

Dividends on WRECo. common stock.....	\$27, 527, 364
Dividends on WRECo. preferred stock.....	1, 057, 890
Dividends on stock of Capital Transit Company and its predecessors.....	146, 195
Interest on obligations of Capital Transit Company and its predecessors.....	298, 470
Profit on sale of WRECo. preferred stock.....	282, 131
	29, 312, 050

can then distributed 414,767 of these units among its stockholders, and retained 65,233 units. The units distributed sold over the counter at prices ranging between \$17 and \$23. The plan was to deposit all of the shares held by North American. It was contemplated that the units would sell on the average of \$20, or \$800 per share of stock. The proceeds would thus be about \$49,750,000, and the profit to North American and its stockholders on the disposition of the stock would thus be approximately \$37,000,000. This plan, however, was arrested in its development, because the deposit of any substantial part of the remaining 50,197 shares with the Bankers Trust Company would have made the latter a holding company under the Public Utility Holding Company Act and the S. E. C. regulations made pursuant thereto.

The third plan is still in its period of gestation.²⁸ It has not

²⁸ In testifying about his computations of the rate of return to be allowed, the Commission's Chief Accountant stated that these related to the present capitalization (Tr. p. 1055, 1058). Asked whether a recapitalization was in contemplation, he answered in the affirmative (Tr. p. 1070; see, also, p. 1169). The plan in question was formulated in 1940 (Ex. 74, Sch. 9). Toward the end of 1941, Counsel and the President of PEPCo. sought to interest me, as the then Chairman of the Commission, in the reorganization plan, but they desired to have the matter kept in confidence. They were informed that I could not accept such matters as confidential or secret, since they related to my official duties. Early in 1942, I attended a conference on this plan in the office of Mr. R. R. Dunn, then Senior Analyst in charge of North American matters in the Public Utilities Division of the Securities and Exchange Commission, and the same Counsel for the Company attended that conference. I then made my position clear that I could not lend my support to the adoption of a plan contrary to existing law, and that I could not favor legislation which would be by way of relief from laws already violated. In August 1943, the same Counsel and Mr. Dunn, who had since resigned from the S. E. C. and become Assistant to the President of PEPCo. and WRECo. (Tr. p. 3186-7) appeared at a conference on substantially the same reorganization plan (Exh. 74, Sch. 9) in the office of the Public Utilities Division of the S. E. C., which conference was also attended by the present Chairman of the Commission and myself. There I reiterated the views expressed at the previous conference. The present plan (Exh. 74, Sch. 11) is a more detailed elaboration of the plan previously discussed. Later, on November 24, 1943, and January 14, 1944, at two conferences between members of this Commission and of the S. E. C., I held to the same view and wrote a memorandum to this Commission in which I recommended that, instead of approving the reorganization plan, action should be instituted to require the North American Company, as *trustee ex maleficio*, to account for all the stock it had held in the local utilities and all of the profits it had de-

been "formally" submitted, but the members of both this Commission and the Securities and Exchange Commission have discussed it. In other words, it is a plan in contemplation. The warp and woof of this plan is to change the present PEPCo. stock from \$100 par value to \$10 par value, to issue 550,000 new shares of the same par value, to transfer \$17,000,000 from

rived from such unlawful holdings; also, that the matter be referred to the Attorney General and that a special report of this matter be transmitted to Congress. Upon action taken by the Commission, the matter was referred to the Attorney General for his opinion and such action as he might deem appropriate. Together with the Chairman's letter to the Attorney General were transmitted the S. E. C. report above referred to (see note 22, supra) and a reorganization plan submitted by the North American Company to the S. E. C. on August 4, 1943, but this was not the reorganization plan which was the subject of discussion between the two Commissions, and which occasioned the reference of the matter to the Attorney General (Exh. 74, Sch. 12).

In their brief (p. 26), Counsel for PEPCo. refer to a newspaper comment which they attach as an appendix to the brief, concerning my memorandum to the Commission on this reorganization plan. Counsel state that the memorandum was made available to Mr. Booth, representing the Treasury Department, Mr. Johnstone, representing the Federal Works Agency, and the press, whose comment they say "we assume to be an entirely fair statement since it has not been contradicted."

Although I had written the memorandum, and I was the only Commissioner who did not think this matter should be clothed with secrecy, I did not give it to the press. It is more likely that the memorandum was given to the press by some agent-provocateur apparently to provoke the Company's charge of bias or unfairness (Tr. p. 4065) and perhaps also to lay a foundation for this very comment by PEPCo's Counsel. The inference that the newspaper comment was fair, since it has not been contradicted, is ridiculous. Aside from the question as to the propriety of a public officer getting down "into the gutter", so to speak, to contradict newspaper comments of this character, it may also be fairly observed that if I had undertaken to contradict all the falsehoods, misrepresentations, half truths and misleading statements so written, I should probably have had little time left for my work in the public service. We must take the bitter together with the sweet. "Yellow journalism" is an incident to the freedom of the press which the Constitution guarantees to those who own or control the means for exercising that freedom. It is to be hoped that in any rebellion against such abuses of this freedom, which must occur from time to time, we shall not go too far and put limitations on the genuine exercise of freedom of thought. Unfortunately, too often in an attempt to eradicate an evil, the cure is apt to destroy that part of the organism which is also a source of social good.

Of course, I made the memorandum available to Counsel for the intervenor. I did this on the theory that where the Commission is in possession of evidence which is of help to any party in a proceeding before it, it

earned surplus to capital stock, and to issue 1,700,000 shares of common stock as a stock dividend. Thus PEPCo. would have a total of 3,150,000 shares having a par value of \$31,500,000 to be owned mainly by North American directly and would elim-

cannot with any sense of honesty or fairness suppress that information but must make it available. I was especially influenced in this course by the following incident: While studying the records pertaining to the control of North American over the local utilities, I came across a sealed envelope marked "N. F. P." (not for publication). This envelope was opened by me on December 4, 1943. It contained a memorandum written by the then Executive Secretary shortly after North American obtained control of the Washington Rapid Transit Company and the latter filed an application for a straight 10-cent fare. The memorandum was addressed to Major Covell, then Assistant Engineer Commissioner, inviting his attention to the fact that the accounts of the Washington Rapid Transit Company contained numerous errors, that the Chief Accountant was giving over one-half of his time to this Company, since the change in the management of this bus line, in analyzing accounts and making reports, and that in doing this he was of necessity neglecting his other work. The Executive Secretary suggested that a few hours be set aside before the date of the hearing in order that he, Major Covell and the Chief Accountant confer and become thoroughly familiar with the Company's accounting system.

Apparently the participants in the proceeding on the application for the straight 10-cent fare (Formal Case No. 187) knew nothing of this memorandum. Later, when Mr. William A. Roberts, then representing the Federation of Citizens Associations, and later People's Counsel, in his argument in Formal Case No. 200 (Formal Case No. 187 having been consolidated with Formal Case No. 200) referred to the fact that the Transit Company's accounts were not kept properly, he was taken to task for this by Commissioner Brand on the ground that the record contained no evidence of this fact (Formal Case No. 200, Tr. pp. 1350-1). Thus a material fact which was in the possession of the Commission was suppressed and not made available to the public who appeared in opposition to an increase in rates.

To me such action is incompatible with any theory that a public utilities commission must act with fairness, impartiality and in the public interest. Therefore, I have always taken the position that any information in the possession of the Commission relevant to any proceeding of an adversary character must be made available to the parties so that, if they choose to do so, they may make the information part of the record. Since I deem the relationship between North American and the local utilities relevant to this case, I naturally made it available to Counsel for the intervener. I did not take the trouble to make the memorandum available to the Company, first, because it was already in possession of these facts; second, because it has taken the position that its relationship to North American is of no relevancy in the case; and third, because the information contained therein was of no significance unless made part of the record, which obviously was not going to be done by the Company.

inate WRECo., as well as some of its subsidiaries, from the holding company system.²⁹ Then North American will be in a

²⁹ The following is a more detailed analysis of the reorganization plan:

(1) At present, North American and the Bankers Trust Company, as trustee, hold 96% of the common stock of WRECo. WRECo holds 100% of the common stock of PEPCo. and 100% of the Washington and Rockville Railway Company of Montgomery County (hereinafter referred to as Rockville). Rockville, in turn, owns 28% of the common stock of the Braddock Light and Power Company, Inc. (hereinafter referred to as Braddock) and 33⅓% of the Great Falls Power Company (hereinafter referred to as Great Falls). WRECo. also owns 72% of Braddock and 66⅔% of Great Falls, also 50% of the common stock of the Capital Transit Company. North American also holds 1.26% of Capital Transit stock directly. This is the present corporate set-up.

(2) Under the plan proposed, WRECo., Rockville and Great Falls would be eliminated entirely from the corporate system. PEPCo. would own 100% of Braddock, and North American would own and control substantially all of PEPCo. and 51% of the Capital Transit Company, with the possibility that North American may dispose of these holdings some time in the future.

(3) The steps proposed to be taken to accomplish this simplification of corporate structure are as follows:

(a) WRECo. will transfer to PEPCo. its securities in Rockville and Braddock for the following amounts: \$632,500 (being the system book cost of Braddock stock) and \$184,250 (being the book cost of Rockville to WRECo.). The Great Falls power site is to be transferred to PEPCo., and of the \$1,000,000 consideration for the site \$505,000 would be set up as an asset and \$495,000 would be charged to surplus.

The significant point about this part of the reorganization plan is the final acquisition of the Great Falls power site by PEPCo. It has already been seen how PEPCo. acquired a promise to transfer an undivided ⅔ interest in 1912, under a contract which was amended in 1936 to transfer a ⅓ interest, and that for this PEPCo. had issued \$1,000,000 in common stock and had already paid out over \$8,500,000 in dividends. Now the site itself is to be transferred to PEPCo., and, since the system book cost of the site is said to be \$505,696.20, this is the amount to be included in PEPCo.'s assets, while \$494,303.80 are to be wiped out by a charge to surplus. Thus the \$8,500,000 in dividends on a supposed investment of \$1,000,000 will become dividends paid on one-half of such an investment. All these dividends came out of ratepayers for an investment which was never part of the operating plant, but was held by the corporate system for what might be termed "nuisance value." It is a matter of common knowledge that the Potomac River is navigable water of the United States. Periodically, the flood waters cause considerable damage. The Falls can be utilized for power development, flood control, navigation, and recreation. For the 31 years that PEPCo. has held its interest, it has done nothing to develop this great natural resource. It has made no use of it, and, by holding an interest in it, has prevented others from making use of it. For this antisocial interest, the public and the United States itself, as the principal consumer, have paid

position to dispose of its holding at a tremendous profit. Since the plan calls for transfer of stock to a foreign holding corporation, it cannot be accomplished without relief from the Anti-merger Law, and since the plan calls for distribution of stock dividends, it cannot be accomplished without relief from Paragraph 75 of the Public Utilities Law, which forbids the distribution of stock dividends. On June 14, 1944, after close of the hearings in this case, an application for approval of this plan was filed with the S. E. C.

out over \$8,500,000. With this reorganization, the \$1,000,000 par value of common stock actually become stock of a par value of \$2,888,888. (As will be seen presently, the \$9,000,000 par value common stock is to be increased to \$26,000,000 by a stock dividend. The \$1,000,000 of common stock issued for the Great Falls power site is $\frac{1}{9}$ of the present outstanding common stock; $\frac{1}{9}$ of \$26,000,000 is \$2,888,888.)

(b) WRECo. has a bonded indebtedness of about \$11,000,000, of which \$3,138,450 is a direct obligation, and the remainder consists of obligations assumed by the Capital Transit Company and guaranteed by WRECo. in connection with the Unification Agreement, which, in 1933, resulted in the merger of the street railways in the District of Columbia. The plan calls for the redemption of bonds in the sum of \$7,201,845, and the receipt of \$3,720,500 from the Capital Transit Company in discharge of the latter's obligation to WRECo. In order to accomplish this step, two preliminary steps must be taken to provide WRECo. with funds. It will be necessary that the Capital Transit Company recapitalize its long-term debt and discharge its bond obligation of \$3,720,500 held by WRECo. It will also be necessary to provide funds to WRECo. to redeem its bonds in the amount of \$7,201,685, and to pay for the cost of reorganization of \$250,000, or a total of \$7,451,845.

(c) At the time when the plan was informally submitted, WRECo. had cash on hand in the sum of \$457,800. PEPCo. was to pay \$632,500 for Brad-dock's stock. WRECo. was to sell, or distribute to its stockholders, mainly North American, by way of dividends, its 120,000 shares of common stock in the Capital Transit Company at \$15 per share, thus raising an additional sum of \$1,800,000. (Since the stock is to be sold or distributed mainly to North American, this part of the plan comes in conflict with the Antimerger Law.) Still the above-stated funds would provide only \$2,870,300, which is \$4,561,545 short of the goal.

(d) To raise this money and something besides, it is proposed that PEPCo. issue 550,000 shares of common stock having a par value of \$10 per share to WRECo., and WRECo. would immediately sell (or distribute to its stockholders) these shares at \$15 per share, thus realizing a profit of \$2,750,000. This, together with the \$3,720,500 resulting from the redemption of bonds by the Capital Transit Company, would make \$6,470,500, which would enable WRECo. to pay the \$4,561,545 and still have \$1,908,955 in cash.

It will be noted at this point that the 550,000 shares are to be issued at \$10 per share. At present the common stock consists of 90,000 shares hav

As the matter stands now, PEPCo. is an integral part of this foreign holding company system. All of its stock is owned by WRECo., while North American holds 50,197 shares, or 77.2% of the common stock of WRECo.³⁰ Together with this stock ownership also came other types of control, namely, through the voting of the stock, through common officers and directors, and through the employment of common counsel, all of which is contrary to law. These, in sum and substance, are the

ing a par value of \$100. At present the earned surplus of the Company is about \$29,000,000, which, together with the capital stock of \$9,000,000, makes a common stock equity of \$38,000,000. If \$5,500,000 were to be derived from the sale of 550,000 shares, the common stock equity would be about \$44,000,000, or about \$30 per share of the new 1,450,000 shares. By selling these shares to WRECo. at \$10 per share, PEPCo., in effect, declares and pays a 200% stock dividend, contrary to Paragraph 75 of our statute. (See *Re Potomac Electric Power Co.*, 44 P. U. R. (N. S.) 277,290.)

(e) WRECo. has outstanding \$8,500,000 in preferred stock which is to be redeemed. To accomplish this, it is proposed that PEPCo. issue \$8,500,000 preferred stock to WRECo. as a dividend, and the latter redeem its preferred stock for that of PEPCo. preferred stock. This would also be in violation of Paragraph 75. At the same time, PEPCo. is to *redeem* its presently outstanding preferred stock in the amount of \$7,000,000 for \$7,490,000, and is to charge \$490,000 to surplus. Apparently the \$7,000,000 would come from the following sources: \$5,500,000 from WRECo. for the 550,000 shares of common stock issued to it, and \$1,908,955 which it will have when it will have merged with WRECo., for which amount PEPCo. will take over WRECo's guaranty of three bond issues assumed by the Capital Transit Company under the 1933 Unification Agreement.

(f) As a further step in this plan PEPCo. is to transfer \$17,000,000 from earned surplus to capital stock, and issue 1,700,000 shares to WRECo. Here again this is in conflict with Paragraph 75.

The total shares received by WRECo. would be 2,600,000 which it proposes to distribute to its stockholders at the rate of 40 shares to one, which also would be in conflict with Paragraph 75 and with the Antimerger Law.

(g) North American and its interests would thus come in possession of shares of smaller denominations, would hold 96 percent or more of 3,150,000 shares of PEPCo., plus 120,000 shares of Capital Transit Company stock which North American would be able to dispose of more easily and would thus comply with an order of S. E. C. requiring it to divest itself of its holdings in the District of Columbia utilities.

(4) Evidently the plan cannot be lawfully carried through even if both the S. E. C. and this Commission should approve. It would be necessary to have Congressional legislation which would make the plan possible, namely, (a) removal of restrictions against capitalization of surplus, and (b) removal of the Antimerger restrictions.

³⁰ Together with the Bankers Trust Company, it holds about 96% of the common stock.

origins and relationships of the utility whose rate structure is under consideration.

The position of PEPCo. in this case is that it is not seeking any change in the method of rate regulation. Its evidence is to the effect that, in accordance with the method pursued under the sliding scale arrangement, it experienced a deficiency in earnings in 1943 in the sum of \$715,632. Under the provisions of the sliding scale arrangement,³¹ the Company is entitled to rates for 1944 which would increase its gross revenue by approximately \$3,500,000. Its evidence also shows that without the sliding scale arrangement the Company is entitled to additional earnings in the sum of approximately \$2,000,000 per year, and to a rate increase of \$10,000,000.³² The Company, however, took the position that it was not looking for any increase in rates.³³ It appears strange indeed that this Company should appear so magnanimous as to waive a rate increase of \$10,000,000, or \$3,500,000, or even as much as \$715,000, when in the previous year, when this Commission ordered a rate reduction of \$310,000 in form, although not in substance, the Company appealed to the courts. Such an attitude raises a suspicion that either the Company's computations are based on erroneous hypotheses, or that the Company is actually earning excessive profits, and, therefore, deems it advisable to leave well enough alone.

(2) *The Federation of Citizens' Associations*.—The Federation is an organization of 67 citizens' associations, each of which is an organized group of citizens residing within a geographical part of the District of Columbia. The object of this Federation is to obtain expression of public sentiment upon matters of special interest to all citizens of the District, and to secure and make effective their united action.³⁴ It has been testified by one witness that there are approximately 70,000 members in the

³¹ See Order No. 2564, Sec. 2, Par. (D), p. 146. See, also, Tr. pp. 369 et seq., 393 et seq., 407-10.

³² The Company's object in introducing this evidence was to show how advantageous the sliding scale arrangement is to the public, and at what great sacrifice to the utility (PEPCo. brief p. 27).

³³ Tr. pp. 203, 242, 368, 386, 387, 410, 667, 867, 3854-6.

³⁴ Tr. p. 919 et seq.

various citizens' associations, and by another witness that there are perhaps 60,000 to 80,000 people in the 67 member bodies. The Vice Chairman of the Public Utilities Committee of the Federation of Citizens' Associations entered an appearance "for the purpose of participating in such manner as we may see fit." ³⁵

In a proceeding of this character, one would expect the interest of the membership of the Federation would be that of consumers, and that their financial interest would naturally be adverse to that of the Company. In other words, while it is to the interest of the Company to secure for itself as high a return as the facts and law would permit, it is to the interest of the members constituting the citizens' associations to secure as low a rate as the facts and the law of the case would permit. Here the Federation presented a resolution ³⁶ favoring the continuation of the present sliding scale arrangement as applied. In other words, the position of the Federation and of the Company was the same.

The resolution itself alleged various matters pertaining to the cost of "the old method of periodic valuation proceedings," as compared with the cost of proceedings under the sliding scale arrangement, to the cost of such proceedings to the consumers, and to present prices which might affect a valuation. It alleged that, if a valuation were made now, the consumers might expect an increase rather than a decrease in rates. It alleged that the sliding scale arrangement had saved the consumers of Washington approximately \$90,000,000, as well as the cost of periodic valuations of some \$1,000,000 per valuation. It assumed, as a matter of law, that unless the sliding scale arrangement is continued, extensive valuations must be made, and tremendous sums must be expended to reflect the present price levels in the rate base. Upon these allegations the Federation resolved to request the Public Utilities Commission "to retain the sliding scale arrangement with the Potomac Electric Power Company."

The Vice Chairman of the Public Utilities Committee of

³⁵ Tr. p. 14, comp. p. 335.

³⁶ Exh. 16.

the Federation, upon introducing this resolution, testified³⁷ to the effect that this resolution had been properly adopted by the delegates to the Federation, and that they had understood its import. On the latter point, he emphasized that the member bodies of the Federation had full knowledge of the sliding scale arrangement, because he had sent them copies of a brief he filed in the United States District Court for the District of Columbia in the 1943 rate case in support of the sliding scale arrangement and in opposition to the appellants in that case, who claimed that they had been denied a full and fair hearing, and that the rates so established were unjust and unreasonable. His further testimony on this point was more in the nature of argument. He emphasized that the allegation in the resolution, to the effect that the consumers had had rate savings totalling \$90,000,000 was really an understatement, that the total reductions were actually in the neighborhood of \$200,000,000; that the members of the Federation appreciated this fact, because he had told them that the sliding scale arrangement "had saved us a lot of money in our pockets, and that we could feel that money and know what it is." And again he said, "I gave them information on what they had saved, and they could feel the money in their pockets."³⁸

Aside from the phraseology, and waiving informalities, the resolution is at best equivalent to a petition for intervention, setting forth some ultimate statements of fact and some theories of law which, in the ordinary course of the proceedings, should be supported by evidence. The resolution itself is admittedly not evidence on the merits of the case, but only of the desires of the members of the Federation. The question, therefore, arises: Of what significance is such a resolution in a proceeding of this character where the determination must be made upon the facts and the law of the case?

It is clear that had the resolution requested the Commission to fix rates or to adopt a method of rate making in opposition to the interests of the Company, the resolution could play no part in the decision of the case. The decision would have to

³⁷ Tr. pp 735-772.

³⁸ Tr. pp. 767, 769, 774.

be based upon the evidence and in accordance with the law. Does a different result obtain when a group of consumers, no matter how large, expresses a desire which is in accord with the interests of the Company and in opposition to interveners who may constitute a small group, but which, under the law, has a right to a fair hearing and to a determination of rates which are just and reasonable?

Here the Federation is said to consist of some 60,000 to 80,000 members. There is no evidence how many of these members are customers of the Potomac Electric Power Company. Assuming that they are all ratepayers, and that each of them represents a separate meter, it must be noted that they constitute about one-third of the number of residential consumers.³⁹ The evidence also shows that the Company's revenue from all residential sales of electricity was only about \$6,000,000 in 1943. It may, therefore, be estimated that these 60,000 members represent approximately \$2,000,000 of the revenues from sales of electric energy, and that this constitutes less than 10% of the entire revenue from sales of electric energy. The intervener in this case, the United States Government, during the same year, paid approximately \$5,000,000, which represents approximately 23% of the revenue. It would indeed be unfair to say to the intervener that its right to just and reasonable rates must be limited, because the Federation or its members want to pay more, rather than less, for electric energy. Obviously, the resolution can play no part in the determination of this case.

(3) *The United States of America.*—The United States of America intervened in this proceeding through two of its agencies, the Procurement Division of the Treasury Department and the Federal Works Agency.

The United States of America has a very substantial interest in this proceeding. The evidence shows that the Government consumes about one-third of the energy sold by PEPCo., and that it pays about one-fourth of the Company's gross revenue. Despite these facts, Counsel for the intervener took the position that the Government was not seeking any preferential

³⁹ Exh. 70.

rate.⁴⁰ In view of this position, it must be concluded that the Government was representing not only its own interest, but also that of the consumers generally.

In form, it would seem, the two agencies were in opposition as to the question whether the sliding scale arrangement should be abandoned. The Treasury Department, in its petition for intervention, and throughout the proceeding, took the position that it was not seeking the abandonment of the sliding scale method of rate determination as such,⁴¹ but that this method should be so modified that the rates and basic elements therein, including depreciation, should conform with the requirements of the statute; that the rates be determined on an original cost rate base; that the Company should be prevented from collecting excessive profits; and that adequate effect be given to current economic and war-time conditions. The Federal Works Agency, in its petition for intervention, took the position that the sliding scale arrangement should be abandoned.⁴² It pointed out many evils inherent in the sliding scale arrangement and asked that the rates determined be just, reasonable and nondiscriminatory. It agreed, however, that there was no clear line of demarcation between modification and abandonment, and that if a sliding scale method of rate determination could be devised so as to balance properly the interests of the consumers and the investors, and so that the rates determined would be just, reasonable and nondiscriminatory, the position of the Federal Works Agency would be fully satisfied.⁴³ The opposition between the two agencies with respect to this question was, therefore, only a matter of form, rather than of substance.⁴³

D. Scope and plan of hearing

The presentation of testimony was artificially divided into three parts according to the questions raised in the order of

⁴⁰ Tr. pp. 7-8; see, also, Treasury brief p. 18.

⁴¹ Tr. p. 245.

⁴² Tr. pp. 7, 12.

⁴³ Tr. pp. 292-294.

⁴³ In their briefs, Treasury takes the position that the rates should be reduced for 1944 by an amount ranging between \$3,650,000 and \$5,250,000 on various theories suggested; F. W. A. argues for a prudent investment rate base which would involve a reduction of some \$5,000,000. Both favor annual rate adjustments.

investigation and notice of hearing: First, whether the sliding scale arrangement should be abandoned; second, whether it should be retained; and third, whether it should be modified. The last question was in turn divided into its components—the modifications relating to the rate base, the rate of return, the depreciation accruals and the method to be followed in effecting rate adjustments. It soon became evident, however, that such a division was very unrealistic, because the evidence under each of these topics was also pertinent evidence under the other topics.⁴⁴ It is not necessary to belabor this point with illustrations.

In a proceeding of this character a great amount of controversy centers around the meaning and evaluative effect of the concepts used. What may appear to be evidence tending toward the retention of the sliding scale arrangement under one set of concepts may at the same time constitute evidence tending to show that the sliding scale arrangement should be abandoned under another set of concepts, or under seemingly the same concepts. For this reason, it is highly important to resort to fundamental analysis. For this purpose it would appear more logical to divide the issues into two main subjects. *First*, should the sliding scale method of rate regulation be retained or abandoned? *Second*, if the sliding scale is to be neither retained nor abandoned in its entirety, what modifications should be adopted?

II. Should the sliding scale be retained or abandoned?

The question at issue is whether the sliding scale arrangement should be retained or abandoned. The answer must depend largely upon the meaning of the phrase "sliding scale arrangement." (A) Is the phrase "sliding scale arrangement" used in the generic sense of any sliding scale method which would insure a reasonable return to the Company and just and reasonable rates to the consumers, without specific limitation to past practices? (B) Is the phrase "sliding scale arrangement" used with emphasis on the word "arrangement," and does it imply consent of the utility as a necessary element in this method of rate regulation? (C) Does the question have

⁴⁴ E. g., Tr. pp. 84, 338, 876.

reference to the sliding scale method embodied in the Consent Decree of 1924? (D) Does the question have reference to the sliding scale arrangement as it has been applied?

A. The sliding scale method of rate making

The uncontradicted evidence shows that a sliding scale method of annual rate adjustments is bound to result in a greater degree of fairness, both to the utility and to the public than the "orthodox" ⁴⁵ method of rate making, provided that the elements entering into the application of the sliding scale method are proper."

In the ordinary course of rate making, a great deal is left to chance. Although the object is to establish rates which would be just and reasonable, the rates are computed upon the plant, revenue and expenses of a given year, and then the regulatory agency trusts to luck that the rates so established will continue to bear the same relationship to the plant, revenue and expenses in the future years. It is expected that as time passes the plant will grow; the revenue will grow; but so also will the expenses; and that the rate of return will remain substantially the same. It is expected, also, that if the growth of the plant and revenue will be at a rate greater than the growth of the expenses, a new rate proceeding will be instituted, and the rates will be lowered; or, if the expenses grow at a rate greater than the plant or revenue, a new rate proceeding will be instituted, and the rates increased.

In reality, the new rate proceedings do not follow this simple pattern. Rate determinations have been made unduly prolix. They have been attended by unnecessary valuations; they have taken much unnecessary time, money and effort. Generally a new rate proceeding is not instituted, unless and until the earnings of the utility are so excessive that there is a great public demand for a rate reduction, or unless and until the earnings are

⁴⁵ The term "orthodox" has been used in two different meanings: (1) In the sense that with each rate proceeding the Commission makes a valuation of the property used and useful as the rate base, and (2) in the sense that the rate base is the value of the property, be it present value or original cost, as distinguished from the method of determining rates upon capital invested in the utility itself. Comp. Tr. pp. 95-99 and 2889-90.

⁴⁶ See Tr. pp. 60, 64, 76-78.

so unreasonably low that the utility must overcome public opposition to increases in rates. The public pressure is itself a complex phenomenon, dictated by many causes other than the facts and the law pertaining to rate making. The result has been that the rates, though said to be fair and reasonable when made, often become unfair and unreasonable and continue so for long periods of time.

Under a method of annual adjustments in accordance with a given plan, which is all that the sliding scale method implies,⁴⁷ the relationship between the rates on the one hand and the economic or financial facts on the other does not get out of bounds. This fact alone is a most persuasive argument for adherence to the view that the rates should be determined annually upon a simple sliding scale method.

It must be assumed, however, that in the determination of rates for each year, the rates determined conform to the requirements of law, and are just and reasonable. It must also be assumed that if the result is otherwise, i. e. if the experience during the rate year is such that the return to the Company is greater than what has been determined to be reasonable, compensating elements must be adopted whereby the excessive payments made by the public would be returned; or, if the experience during the rate year is such that the return to the Company is less than what has been determined to be reasonable, the Company should be permitted to recoup its loss. In this manner, there is a virtual guaranty of a fair return to the utility, which is a great advantage to it. This advantage, however, should also inure to the public. Where risks of investment are reduced to a minimum, the burden on the part of the public to support the utility's capital structure should likewise be reduced to a minimum.⁴⁸ Thus a sliding scale method can have the additional advantage of reducing the cost of utility service to the public.

B. Consent of the utility

Is it necessary to have the consent of the utility for an annual adjustment of rates under a sliding scale method? In other

⁴⁷ Tr. p. 1817.

⁴⁸ Order No. 2682, p. 28.

words, does the application of such a method necessarily involve an arrangement, understanding or agreement with the utility? This question arises in two ways: (1) Is such a requirement inherent in Paragraph 18 ⁴⁹ of our statute, and (2) are there any other obstacles to such method of rate determination without the utility's consent.

(1) *Meaning and effect of Paragraph 18.*—Paragraph 18 merely provides that nothing in the Law Creating the Public Utilities Commission shall be interpreted to prohibit a public utility from providing a sliding scale of rates and dividends or other financial device that may be practicable and advantageous to the parties interested. Obviously, the parties interested are the Company, its investors and the consumers. The adoption of such a device is made dependent on the consent of the Commission, which consent, however, may be given only upon a finding that the arrangement is reasonable and just and not inconsistent with the purposes of the Act. This means that any such device must provide rates which are in conformity with the requirement that they shall at all times be just, reasonable and nondiscriminatory as is provided in Paragraph 2 ⁵⁰ of the

⁴⁹ PAR. 18. That nothing in this section shall be taken to prohibit a public utility, with the consent of the commission, from providing a sliding scale of rates and dividends according to what is commonly known as the Boston sliding scale, or other financial device that may be practicable and advantageous to the parties interested. No such arrangement or device shall be lawful until it shall be found by the commission, after investigation, to be reasonable and just and not inconsistent with the purposes of this section. Such arrangement shall be under the supervision and regulation of the commission. The commission shall ascertain, determine, and order such rates, charges, and regulations, and the duration thereof, as may be necessary to give effect to such arrangement, but the right and power to make such other and further changes in rates, charges, and regulations as the commission may ascertain and determine to be necessary and reasonable, and the right to alter or amend all orders relative thereto, is reserved and vested in the commission notwithstanding any such arrangement and mutual agreement.

⁵⁰ PAR. 2. That every public utility doing business within the District of Columbia is required to furnish service and facilities reasonably safe and adequate and in all respects just and reasonable. The charge made by any such public utility for any facility or services furnished, or rendered, or to be furnished or rendered, shall be reasonable, just, and nondiscriminatory. Every unjust or unreasonable or discriminatory charge for such facility or service is prohibited and is hereby declared unlawful. Every public utility is hereby required to obey the lawful orders of the commission created by this section.

statute, and that the dividends shall also conform to the provisions of law and to sound business practices. The Commission is charged with a continuing duty to ascertain, determine and order rates, charges and regulations which would give effect to the arrangement, but the right and power to make any changes in the rates, charges and regulations are by statute reserved to the Commission, notwithstanding any such arrangement and the consent thereto.⁵¹ This last provision negatives any assumption that the operation of the arrangement or device must carry with it the consent of the utility.

Does this provision mean that a sliding scale method of rate determination is possible only if initiated by the utility and consented to by the Commission?⁵² Obviously not. The statute requires the Commission to fix and determine rates which are just and reasonable. Except as provided in Paragraph 16⁵³ of the statute relating to depreciation, the methods of arriving at such rates are entirely within the discretion of the Commission, subject, of course, to such limitations as are imposed by general law. The Commission may, therefore, fix and determine just and reasonable rates in accordance with a sliding scale method, and so long as the rates so determined are just and reasonable, the utility's consent is not necessary at all.

⁵¹ Order No. 2564, pp. 36-38.

⁵² Tr. pp. 1915-6. PEPCo. brief pp. 5-7.

⁵³ PAR. 16. That every public utility shall carry a proper and adequate depreciation account. The commission shall ascertain and determine what are the proper and adequate rates of depreciation of the several classes of property of each public utility. These rates shall be such as will provide the amounts required over and above the expense of maintenance to keep such property in a state of efficiency corresponding to the progress of the industry. Each public utility shall conform its depreciation accounts to such rates so ascertained and determined by the commission. The commission may make changes in such rates of depreciation from time to time as it may find to be necessary. The commission shall also prescribe rules, regulations, and forms of accounts regarding such depreciation which the public utility is required to carry into effect. The commission shall provide for such depreciation in fixing the rates, tolls, and charges to be paid by the public. All moneys in this fund may be expended in keeping the property of such public utility in repair and good and serviceable condition for the use to which it is devoted, or invested, and, if invested, the income from the investments shall also be carried in the depreciation fund. This fund and the proceeds thereof shall be used for no other purpose than as provided in this paragraph, unless with the consent and by order of the commission.

If the Commission may make changes in a sliding scale arrangement adopted by the Company with the Commission's consent, it follows *a fortiori* that the Commission may effect the same changes or adopt the same arrangement without it first having been initiated by the utility. The consent of a utility to a method of rate determination may be indicative of a realization on its part that the result is fair and reasonable. To this extent the utility's consent is desirable. On the other hand, the consent of the utility may be indicative of an agreement to the method of rate determination because thereby the utility is allowed earnings which are more than fair and reasonable. Then the sliding scale method is merely regulation by consent, rather than by operation of law. Regulation by consent which would inure to the benefit of the utility to the extent that it would enjoy a return which is more than just and reasonable is expressly forbidden by our statute, which requires all rates to be just and reasonable, reserves the right and power in the Commission to fix rates which are just and reasonable, notwithstanding any arrangement or agreement, and imposes on the Commission a continuing duty to enforce the provisions of the statute.⁵⁴ It must, therefore, be concluded that while the utility's consent may be desirable, if the norms of the statute are complied with, such consent is not at all necessary.

(2) *Other alleged obstacles.*—While admitting that if the rates fixed yield a return which is fair and reasonable, the consent of the utility is not a necessary element in a sliding scale method of rate regulation,⁵⁵ the President of the Company also testified that if any substantial changes are made in the present sliding scale arrangement, he would “strongly urge the Directors of the Potomac Electric Power Company not to enter into such arrangement.”⁵⁶ One must, therefore, consider what are

⁵⁴ PAR. 90. That the commission shall inquire into any neglect or violation of the laws or regulations in force in the District of Columbia by any public utility doing business therein, or by the officers, agents, or employees thereof, or by any person operating the plant of any public utility, and shall have the power, and it shall be its duty, to enforce the provisions of this section as well as all other laws relating to public utilities.”

⁵⁵ Tr. pp. 226-7; see, also, the testimony of Dr. Bonbright, Tr. pp. 2262-5.

⁵⁶ Tr. p. 203, 220.

the obstacles, if any, in the way of pursuing a sliding scale method of rate determination without the utility's consent. It has been suggested that there are two obstacles: (a) the possibility of litigation; and (b) the alleged requirement of law that rates must be based on "present fair value."

(a) *Threat of litigation*.—Whenever one questions the proprieties of the sliding scale arrangement with PEPCo., it is pointed out that the valuation arrived at in 1917 had been litigated in the Courts until 1924, when the case was finally terminated by the Consent Decree. Otherwise, it is argued, the case might have continued indefinitely. The spectre of that litigation has haunted the present proceeding.⁵⁷

Threat of litigation is a good thing, to the extent that it serves to protect one's rights. In this case, the threat of litigation by the Company, to the extent that it is entitled to a reasonable return, would, of course, be proper. On the other hand, threat of litigation becomes a vicious thing, if employed as a vehicle for exacting more than a reasonable return. It behooves the Commission, therefore, to safeguard the rights of both the utility and the public. Having so fixed its rates, it renders itself *functus officio*. Then, if the utility threatens to litigate the matter, it should not be recompensed for desisting from doing so.

Public utility regulation has been a fruitful field for litigation because of the fact that the costs are always shifted to the consumers. Whether or not there is good cause for appeal to the courts, whether or not the utility is successful in its appeal, the public pays the bill, since such costs are regarded as "operating expenses." Yet, a different treatment must be given to costs of litigation, if it is considered that a utility may expend money only in the service of the public. If there is no substantial reason for litigation, the costs involved are not expenditures made in the service of the public, but in the service of the stockholders. They should, therefore, bear the burden of these costs, not merely those generally known as "court costs," but all of the legal fees, the time devoted to such litigation by the management and employes, the use of the Com-

⁵⁷ Tr. pp. 57, 192-3, 212-3, 227-8, 236; see, also, Exh. 16, Tr. pp. 2075, 3956-7.

pany's facilities, etc. Nothing will discourage such litigation as effectively as a realization on the part of the stockholders that they, rather than the consumers, must pay such costs.

(b) *Requirement of fair value.*—There is also the suggestion made by the Company, the Federation, and even by the Commission's own principal witness that the only alternative to a sliding scale arrangement is the "orthodox" method of rate regulation, by which they mean rate determination upon a valuation made to ascertain the fair value of the property.⁵⁸ In other words, the claim is that, in the absence of consent by the utility, the Commission would have to make a valuation of the property with each rate proceeding, and this would be an effective obstacle to annual rate adjustments.

It must be admitted that if a "fair value" proceeding is a necessary prerequisite for each rate revision, then annual rate determinations cannot be made without the consent of the utility.⁵⁹ The time consumed in such an undertaking would make the sliding scale method impossible of application. It becomes necessary, therefore, to determine whether valuation to ascertain the fair value of the Company's properties is a necessary prerequisite to rate regulation in this jurisdiction.

It is now clear, since the decision of the Supreme Court in the *Hope Natural Gas Case*⁶⁰ that, in the absence of a statutory requirement to the contrary, rates may be based on the actual legitimate original cost of the utility's property. The utility is entitled to a return on its investment, not on an investment contributed by others; it is not entitled to earn a return on any increment in value not contributed by the Company, but by the general economic conditions; nor is it entitled to a return on any part of its property paid for by the consumers by way of depreciation, operating expenses or otherwise.

It is also clear that there is no express statutory requirement

⁵⁸ Tr. pp. 9-11, 78, 81, 203; see, also, p. 1818. PEPCo. brief pp. 8-11.

⁵⁹ On the other hand, it must also be observed that if the utility will not consent to an annual rate adjustment, unless its return is more than just and reasonable, then such a method of rate regulation is rendered impossible by the statute.

⁶⁰ *Federal Power Comm. v. Hope Natural Gas Co.*, — U. S. —, 88 L. Ed. 276.

that the rates in the District of Columbia must be based on something other than the actual legitimate original cost of the property used and useful in the service. Paragraph 6⁶¹ of our statute requires the Commission to ascertain the cost of utility property, the replacement or reproduction cost of such property, the outstanding securities, credits due to the utility, the amounts paid for other property including franchises, and the taxes paid thereon, the net income of the utilities, salaries paid to officers, wages to employees, and their hours of service. Nothing in this paragraph requires the Commission to apply the data in rate making, in one manner or another.

Paragraph 7⁶² requires the Commission to value the utility properties used and useful for the convenience of the public at the fair value thereof "at the time of valuation." Paragraph

⁶¹ PAR. 6. That the commission shall ascertain, as soon and as nearly as practicable, the amount of money expended in the construction and equipment of every public utility, including the amount of money expended to procure any right-of-way; also the amount of money it would require to secure the right-of-way, reconstruct any roadbed, track, depots, cars, conduits, subways, poles, wires, switchboards, exchanges, offices, works, storage plants, power plants, machinery, and any other property or instrument not included in the foregoing enumeration used in or useful to the business of such public utility, and to replace all the physical properties belonging to the public utility. It shall ascertain the outstanding stock, bonds, debentures, and indebtedness, and the amount, respectively, thereof, the date when issued, to whom issued, to whom sold, the price paid in cash, property, or labor therefor, what disposition was made of the proceeds, by whom the indebtedness is held, so far as ascertainable, the amount purporting to be due thereon, the floating indebtedness of the public utility, the credits due the public utility, other property on hand belonging to it, the judicial or other sales of said public utility, its property or franchises, and the amounts purporting to have been paid, and in what manner paid therefor, and the taxes paid thereon. The commission shall also ascertain in detail the gross and net income of the public utility from all sources, the amounts paid for salaries to officers and the wages paid to its employees, and the maximum hours of continuous service required of each class. Whenever the information required by this paragraph is obtained it shall be printed in the annual report of the commission. In making such investigation the commission may avail itself of any information in possession of any department of the Government of the United States or of the Commissioners of the District of Columbia.

⁶² PAR. 7. That the commission shall value the property of every public utility within the District of Columbia actually used and useful for the convenience of the public at the fair value thereof at the time of said valuation.

8⁶³ provides that in such instances the Commission shall hold a hearing upon thirty days notice to the public utility, and that it transmit copies of the valuation determined both to the utility affected and to the District Committees in Congress. Paragraph 9⁶⁴ provides for revaluations of property of public utilities. Nothing in these paragraphs contains a direction that the data gathered, or the determinations made, must, in one way or another, be used in rate making.

These paragraphs are followed by others relating to financial statements, reports and accounts of the utilities, in none of which is there any direction to the Commission how the facts gathered shall be used for rate-making purposes. In Paragraph 16,⁶⁵ however, relating to the depreciation account, there is a specific direction that the rates of depreciation determined shall be also the rates of accural for depreciation to be used in rate making. The inclusion of a specific direction in Paragraph 16 is sufficient indication that the preceding paragraphs were not intended to operate as specific directions for rate-making purposes.

Subject to the provisions in Paragraph 2, that all rates and charges must be just and reasonable, and subject to the provisions as to depreciation in Paragraph 16, the determination of rates is left by the statute entirely within the discretion of the Commission. There is, therefore, no room for the assertion that the statute *directly requires* this Commission to determine rates which would constitute a reasonable return upon a value other than the cost of the property, albeit there is also no requirement that cost shall constitute the rate base.

It is said, however, that when Congress enacted the Public Utility Law, the legislators were under the impression that the

⁶³ PAR. 8. That before final determination of such value the commission shall, after notice of not less than thirty days to the public utility, hold a public hearing as to such valuation in the manner hereinafter provided for a hearing, which provisions, so far as applicable, shall apply to such hearing. The commission shall, within ten days after such valuation is determined, serve a statement thereof upon the public utility interested, and shall file a like statement with the District Committees in Congress.

⁶⁴ PAR. 9. That the commission may at any time, on its own initiative, make a revaluation of the property of any public utility.

⁶⁵ See note No. 53, *supra*.

Constitution required the ascertainment of "fair value" as the basis for rate making. Does this mean that Congress wrote this law with the intention that "fair value" other than cost continue to haunt utility regulation even if it be finally determined that there was no such Constitutional requirement? I think not. The intention undoubtedly was that just and reasonable rates be determined in accordance with the law of the land. In deference to the Supreme Court, its pronouncements are regarded as being the most authoritative determination of what the Constitution requires. However, the Supreme Court, like any other human institution, may reconsider important questions and arrive at a different conclusion. When it did so in the *Natural Gas Pipe Line Company*⁶⁶ case and in the *Hope Natural Gas* case, the Court did not say that prior thereto the Constitution laid down one requirement and now another. It held that there was no such Constitutional requirement. According to this decision, there never was such Constitutional requirement, although even the Supreme Court mistakenly thought that there was. Therefore, if Congress did intend that "fair value" other than cost be at the basis of rate determination, because it was required by the law of the land, it certainly was not the intention of Congress that the determination of just and reasonable rates must be guided by a rule of law not in existence.⁶⁷

Then it is said that throughout the years since the enactment of the statute, this Commission has regarded the determination of "fair value" for rate-making purposes as being required by Paragraphs 7 and 9 of the statute; that there is, therefore, a uniform administrative interpretation which must be regarded as reflecting the intent of Congress. This contention is without merit. A uniform administrative interpretation is undoubtedly evidence of the Congressional intent and should be given great weight. Not so, however, when the actions of the Commission do not conform to the interpretation. With all the

⁶⁶ *Federal Power Commission v. Natural Gas Pipe Line Co.*, 315 U. S. 575.

⁶⁷ *United States v. Southeastern Underwriters Ass'n.*, — U. S. —, decided June 5, 1944, where the anti-trust law was held applicable to insurance companies, though at the time of enactment the rule obtained that insurance was not commerce.

lip service given to "fair value," not a single utility rate in the District of Columbia is now based on any determination of "fair value," whatever meaning may be attached to the term. Neither the electric rates, nor the telephone rates, nor the gas rates, nor the public transportation rates, nor the taxicab rates are based on any determination of fair value as of the time when the rates were determined. When the Commission's action is so at variance with its language, the latter cannot be taken as expressive of the legislative intent.

Finally, it is said that the Court of Appeals for the District of Columbia interpreted the statute as requiring that rates be determined on the fair value,⁶⁸ and that this interpretation is binding on the Commission. It appears, however, that in interpreting this statute the Court merely applied the well-known doctrine that statutes must be so interpreted as to avoid an unconstitutional result. Since it was then assumed that the Constitution required such a basis for rate determination, the Court so interpreted the statute, saying: "It has been ruled many times that there must be a fair return to a public utility 'upon the reasonable value of the property at the time it is being used for the public' (citing cases)." The authorities cited by the Court of Appeals in support of its conclusion were the very cases which have been superseded by the decisions of the Supreme Court in the *Natural Gas Pipe Line* case and in the *Hope Natural Gas* case. The stream of adjudication cannot rise higher than its source. When the Supreme Court removed the foundation, this structure fell. It cannot be said that the law of this jurisdiction now requires rates to be based on fair value, because the law had been so interpreted many years ago, especially when the reason for the interpretation has vanished.

A different interpretation must be expected now. It must not be overlooked that the decision of the Supreme Court in the *Hope Natural Gas* case also involved a question of statutory construction. The Natural Gas Act,⁶⁹ like our own statute, required that rates fixed shall be just and reasonable, and it also authorized the Federal Power Commission to investigate the actual legitimate cost of the property, the depreciation thereon,

⁶⁸ *Potomac Electric Power Co. v. Public Utilities Comm.*, 276 Fed. 327.

⁶⁹ 52 Stat. 833, Sec. 6.

and "when found necessary for rate purposes other factors which bear on the determination of such cost or depreciation, and fair value of such property." In the *Hope Natural Gas* case, it was argued, and the argument was sustained by the Circuit Court of Appeals,⁷⁰ that this was a statutory requirement directing the Federal Power Commission to base its rate determinations on fair value rather than on actual original cost. The arguments were substantially the same as are being urged here. The Supreme Court held, however, that the language of the statute fell short of such a requirement, and that Congress had "provided no formula by which a 'just and reasonable' rate is to be determined." The same result must apply in the case of our statute.

But there is a reason more important than an argument of authority based upon an interpretation of an analogous statute. It is the cardinal rule that statutes must be so interpreted as to avoid absurdity, injustice and unreasonableness.⁷¹ The fair value theory does lead to absurdity, injustice and unreasonableness, which cannot be ascribed to Congress.

(i) As Justice Black pointed out, in his concurring opinion in the *Natural Gas Pipe Line* case,⁷² the term "fair value" in rate cases is an analogy borrowed from eminent domain proceedings where the value of the property taken is measured by the highest or most profitable use of the property at the time of the taking.⁷³ This analogy is not applicable in rate making, because here the value is being determined not merely for the protection of the owner, but for the protection of both the public and the investor. Congress certainly did not intend that public utility property for rate-making purposes be valued on the same basis as in eminent domain proceedings.

(ii) The term "fair value" is also used in the sense of "market value," the price of purchase and sale of property in the open

⁷⁰ *Hope Natural Gas Company v. Federal Power Comm.*, 134 Fed. (2d) 287.

⁷¹ *Huidekoper v. Douglass*, 3 Cranch 1; *United States v. Katz*, 271 U. S. 354; *United States v. Oregon & C. R. Co.*, 164 U. S. 526; *United States v. American Trucking Association*, 310 U. S. 594; *United States v. Ryan*, 284 U. S. 167.

⁷² 315 U. S. 575, 603-4.

⁷³ *Olson v. United States*, 292 U. S. 246. Comp. testimony on the value of the Company's lands, Tr. pp. 3035-3101.

market free from disturbing influences.⁷⁴ It is the price which a willing buyer would give and a willing seller would take. But utilities are not frequent objects of sale in the open market. Without actual sales one cannot estimate with any degree of accuracy at what price the utility, as a whole, might sell. In most instances where there is a sale of a utility as a whole, there are special circumstances which influence the price. For example, the utility may be in financial difficulties and must undergo a reorganization; or the utility may be taken over by a competing utility. Such special instances furnish no basis for estimating the value of utility property, and Congress could not have intended this application of the term "fair value."

(iii) While utilities themselves are not objects of purchase and sale in open market, the component parts of the utilities may be. It is on this theory that the land of the Company was appraised at \$2,943,000.⁷⁵ But this method overlooks the fact that when the utility's property is broken up into component parts, there is a definite effect on the market price. While land may be found to have an increased value, other property may have a second-hand value, while still other property may have only scrap, or scrap less removal value. The total result would in all instances be far less than original cost. Higher measures of value are attributed to the second and especially to the third class of property only because it is operated under some form of a public right, such as a franchise. The inclusion of value added by the franchise, however, really means that the public must pay for the right it has given, which is the same as adding franchise value.⁷⁶

(iv) While public utilities themselves are not usual objects of purchase and sale in the open market, their securities are. Is it possible that Congress intended that the market value of the stock be taken as a measure of the fair value of the property? This would lead to an absurd result, even where the

⁷⁴ *Mo. ex. rel. S. W. Bell T. Co. v. Public Service Commission*, 262 U. S. 276, 293.

⁷⁵ Exh. 59 and 59A, Tr. pp. 3035-3120; see, also pp. 2443-5.

⁷⁶ *Georgia R. & Power Co. v. Railroad Commission*, 262 U. S. 625, 632 and cases cited therein.

stock is fully representative of the actual property.⁷⁷ The market value of stock is high, if the earnings are high. Applying such value to the property would mean that the higher the earnings, the higher should be the rates, whereas in fact this may be the very reason for lowering the rates. Conversely, the market value of the stock is low, when the earnings are low. Accordingly, applying such value to the property would mean that the rates should be low, whereas in fact this may be the very reason for increasing the rates. This, also, is a reduction to absurdity.

(v) Congress could not have meant that "fair value" shall mean reproduction cost, which is itself a concept hypothetical, speculative, unrealistic and thoroughly unreliable.⁷⁸ It is hypothetical, because it assumes theoretically to reproduce something not reproducible. It is speculative because it assumes facts which may or may not exist, and their effect is impossible of ascertainment. A utility usually builds its plant through years of technological changes. When one computes reproduction cost as an indication of present value, one must also view the costs in the light of the present art. When that is done, many items of property may have no more than scrap value. The extent to which obsolescence has set in, making it more desirable to produce something new, is measured entirely by the "judgment" of engineers, with no basic data upon which the regulatory commission could arrive at the same judgment. Finally, reproduction cost, as evidence of present value, is most unreliable. The mere fact that "expert" witnesses arrive at widely different results⁷⁹ is itself an indication that reproduction cost is too elastic a measure of anything, let alone of "fair" value. In short, reproduction cost is not a measure of value.⁸⁰

⁷⁷ *Comp. Federal Power Comm. v. Hope Natural Gas Co.*, — U. S. —, —, 88 L. Ed. 276, 283.

⁷⁸ Tr. pp. 1829, 1836-8, 1882, 1898-9, 2421-2440, 2788-9, 2794.

⁷⁹ In a report made in 1943 by Chairman Jourolmon of the Committee on Progress in Public Utility Regulation of the National Association of Railroad and Utilities Commissioners, he listed many cases in which the appraisals of the Company exceeded the appraisals of the Commissions by over 100%, and in one case by as much as 450% (pp. 24-33).

⁸⁰ Tr. p. 1577.

(vi) A substitute method for ascertaining "reproduction cost" is to use the "original cost trends" method, that is, by translating the costs of the various classes of property, at the time of construction or acquisition, into present costs by means of index figures.⁸¹ The result so arrived at is not reproduction cost, nor any "value," but some figure based on the theory that, if all of the property were reproduced without regard to technological changes, if for every class of property the cost at the present time would bear the same percentage relationship to the original cost when the property was first constructed or acquired, if all other conditions remained the same, and if it were prudent so to acquire such a plant, then the sum of all costs multiplied by their respective ratios would yield this "fair value."

The absurdity of the result thus reached may be illustrated by the testimony in this very case.⁸² Here, by applying the trend cost method, and using the appraised value of land, plus organization and undistributed general construction cost, net additions in 1943 at 1942 price levels, and working capital, the Company's witness arrived at a fair value of \$143,263,174 and at a rate base for 1943 of \$139,376,000. He also testified that on the basis of this value, the fair amount of depreciation is \$22,153,000.⁸³ On the question of rate of return, he was of the opinion that the common stock was entitled to earn 9.5%,⁸⁴ and that the weighted average cost of capital would thus be 5.8%, but that this is the minimum and that 6% would be a fair and reasonable rate of return. He was of the opinion that this rate of return should be applied to the undepreciated rate base and that the Company should be charged with interest at the rate of 4% on the accrued depreciation. On this basis, he arrived at the conclusion that the Company was entitled to a net return of \$7,484,000, which is approximately \$2,000,000 more than the return to the Company for 1943. Since the Company's income is already in the excess profits tax brackets, the rates would have to be increased by more than \$10,000,000.⁸⁵ This,

⁸¹ *Comp. West v. C. & P. Tel. Co. of Baltimore*, 295 U. S. 662, 671-2.

⁸² Exh. 60 and 61, Tr. pp. 3122-3180, 3266-3348.

⁸³ Tr. p. 3149.

⁸⁴ Tr. p. 3168.

⁸⁵ Tr. pp. 3326-30.

according to the witness, is what the Company is entitled to under the law as interpreted to him by the Company's own counsel.

The computations, the witness said, were intended to give the Company a return of 9.5% on its common stock. Yet, the net return of \$7,484,000 would leave \$5,847,000 as earnings on the common stock, which, on the basis of the common stock equity (\$37,440,000)⁸⁶ is 15.8%, on the basis of par value (\$8,000,000) is 73.1%, and on the basis of actual investment in common stock (\$5,245,000) is about 111% per year. How an expert witness can start with a 9.5% return on common stock and end up with 15.8% on the common stock equity is indeed a puzzle. His explanation that he had a different idea of the common stock value after he stated that he had used "approximately the same figure" in his computations, did not help much, for even on that "value," the return was 14.6%, which is considerably more than 9.5%.⁸⁷ In these circumstances it must be concluded that the witness has so discredited his own testimony that it is not entitled to any weight. It must be concluded that Congress could not have intended such results.

(vii) It is said that "fair value" is not any one of the above so-called "elements of value," but a "judgment figure" based on all of them. Can we attribute such an intent to Congress? No less an authority on public utility problems than Justice Brandeis said:⁸⁸

Obviously, "value" cannot be a composite of all these elements. Nor can it be arrived at on all these bases. They are very different, and must, when applied to a particular case, lead to widely different results.

I fully agree with this observation, but I think it is much too charitable. Not only are the results widely different, but the final result is an impossibility. There is no rational basis for such a determination.⁸⁹ A composite figure is one which must

⁸⁶ Exh. 26, Sch. 4.

⁸⁷ Tr. pp. 3331-44.

⁸⁸ *Mo. ex. rel. S. W. Bell Telephone Co. v. Public Service Comm.*, 262 U. S. 276, 295.

⁸⁹ Tr. p. 1831.

be based on competent evidence as to its composition. It is not sufficient to have the figures yielded by actual cost, prudent investment, book cost, capitalization, reproduction cost, trended original cost, and others. To arrive at a "fair value" in which all these play a part, it is necessary to have evidence showing in what manner and to what extent each of these contributes to the result. An examination of "fair value" determinations, however, fails to reveal how the result arrived at flows from the various so-called elements of value.

(viii) In passing this legislation, Congress must have intended some practical results. A valuation, based on all the so-called elements of value, takes years, and the costs are gigantic. By the time a valuation is made, the "fair value" arrived at is no longer representative of the value of the property as of the time when there is need for determining just and reasonable rates. Let us see what has been the experience of this Commission in this regard.

On August 23, 1930, the Commission embarked upon an investigation of the fair value of the street railway properties. On August 29, 1938, the Commission finally arrived at a "fair value" figure as of December 31, 1935. This, it is said, cost over \$280,000 in direct expenses and probably much more in indirect costs.

The Washington Gas Light Company applied for a revaluation on January 19, 1926. After lengthy proceedings, this Commission on March 19, 1935, arrived at a "fair value" as of June 30, 1932. This, I am informed, cost over \$750,000 in direct costs.

In the case of the Potomac Electric Power Company, an inventory was begun on June 1, 1914, a valuation order was issued on May 2, 1917. This was tied up in litigation until the end of 1924, and it is said that the cost of this valuation was some \$1,000,000.

Not only were these valuations useless for the determination of just and reasonable rates, but they also involved great financial burdens on the utilities and on the public. The requirement that rates be determined through an administrative process which is prompt, efficient and inexpensive,⁹⁰ cannot

⁹⁰ *Crowell v. Benson*, 285 U. S. 22, 46.

be reconciled with a procedure which takes years, costs a tremendous sum of money and cannot be characterized otherwise than measuring an indeterminate length with an elastic yardstick.

The requirement of promptness, efficiency and economy is reconcilable with the process of determining rates based on the actual legitimate original cost. In this connection, it must not be overlooked that the term "fair value" is an expression impregnated with advertising appeal. It is not descriptive either of "value," nor of any "fairness." Stripped of any ulterior motives, the term "fair value" must be equivalent to actual legitimate original cost. Cost is the normal measure of value.⁹¹ "Fair" value implies that the cost be actual, as distinguished from fictitious; that it be legitimate, as distinguished from transactions which may be tainted with collusion, fraud, or other forms of irregularity or illegality; and original, as of the time the property is first devoted to public use, as distinguished from the times when the property passes from one corporate entity to another, or when the property is exchanged for stock.

Neither history, nor authority, nor reason support the proposition that rates in the District of Columbia must be based on "fair value" as distinguished from actual legitimate original cost. It follows, therefore, that rate adjustments may be lawfully made without valuations, but upon the costs already determined. It follows further that the supposed requirement of valuations is not an effective obstacle to a sliding scale method of rate determination, and that such method may be employed without the consent of the utility.

C. The consent decree of 1924

If the question of abandonment or retention relates to the sliding scale embodied in the Consent Decree of 1924,⁹² it must

⁹¹ Except in those rare instance when, through the breakdown of the monetary system, a new system must be introduced; for example, like the breakdown in the monetary system in Germany after World War I. Compare with what Mr. Justice Reed said in *Federal Power Comm. v. Hope Natural Gas Co.*, — U. S. —, 88 L. Ed. 276, 294. "The evidence of reproduction cost was rejected as unpersuasive, but from the other evidence they found a rate base, which is to me a determination of fair value." That rate base was the actual original cost. See, also, Tr. p. 2005.

⁹² Exh. 10.

be observed that the method therein contained was essentially fair, except that (1) it did not comply with the statutory requirements as to depreciation, and (2) it started with a highly inflated rate base, which, unlike the rate of return, has not been adjusted to present economic standards.

The Consent Decree, after adopting what one might call a "negotiated" rate base of \$32,500,000 and a rate of return of 7½%, provided as follows:

4. If the rates hereafter yield more than a 7½ percent return on \$32,500,000, plus actual cost of future additions undepreciated but weighted during a period of any one year, one-half of said excess shall be used in a reduction of rates to be charged to the public for electric service thereafter, thereby providing a sliding scale of rates under provisions of paragraph 18 of the act creating the Public Utilities Commission, advantageous to the public and company alike; that is to say, by way of example, if the return for any one year should amount to \$100,000 over and above 7½ percent on the base ascertained as aforesaid then the rates for the succeeding year to be charged the public shall be automatically reduced by the filing of new rate schedules to absorb \$50,000 of such excess during such year.

By the language of the Decree, it was contemplated that the fair return was a net operating income which would be equal to 7½% of the rate base, and that the rates should be so fixed as to yield such a return. It was certainly not contemplated that the rates should be so fixed as to yield large excessive profits to the Company. Since, as a matter of practical rate making, it is not possible to fix rates which would yield a given return exactly, it was provided that if the rates fixed resulted in an excess over and above 7½% of the rate base, then the rates for the following year, based on the new rate base, would be so reduced that the Company would "absorb" one-half of this excess.

What is the meaning of the phrase "absorb one-half of such excess"? Two possible interpretations suggest themselves:

First, that if the rates in 1925 yielded a return \$700,000 in excess of 7½% of the rate base, then the rates for the next

year should be so fixed that the return for 1926 would be $7\frac{1}{2}\%$ of the rate base plus \$350,000; that the next year the rates should be so fixed as to yield a return of \$175,000 in excess of $7\frac{1}{2}\%$ of the rate base, and so on until the rates were so adjusted as to yield a return of $7\frac{1}{2}\%$ and no more. This can hardly have been the intent, in view of the uncertainties in rate determinations. Furthermore, with a rate base of \$9,500,000 in excess of the original cost, a rate of return of $7\frac{1}{2}\%$ and its application to the rate base undepreciated, it is difficult to imagine that a court of equity would have given its approval to a decree which would contemplate earnings in excess of such a return. Therefore, this interpretation must be rejected.

The second interpretation, and the only logical one, is that if in 1925 the excess over and above $7\frac{1}{2}\%$ was \$700,000, one-half of this amount should be considered as having already been earned for 1926, and that the rates for that year should be so fixed as to yield $7\frac{1}{2}\%$ of the rate base, less \$350,000. By this method, the Company still retained one-half of the excess earned in 1925. With a proper method of fixing the rates for the rate year, however, the excess earning were bound to be small, and the fifty percent of the small excess could then serve to compensate the Company for contemplated deficiencies in earnings. Furthermore, the adjustment in rates upward was not to be as prompt, for the Consent Decree further provided:

5. If the average return for any consecutive 5-year period falls below $7\frac{1}{2}$ percent on the base ascertained as aforesaid, or if the average return for any consecutive 3-year period falls below 7 percent on the base ascertained as aforesaid, or if the average return for any consecutive 12-month period falls below $6\frac{1}{2}$ percent on the base ascertained as aforesaid, the commission shall promptly increase rates so as to yield $7\frac{1}{2}$ percent on the base ascertained as aforesaid.

In other words, the one-half of the excess earnings retained by the Company in the preceding year was to serve as a cushion to absorb losses of as much as $\frac{1}{2}\%$ of the rate base for five consecutive years, or of as much as 1% of the rate base for 3

consecutive years, and it was only when the return was deficient by more than 1% of the rate base, that the rates were to be increased "so as to yield 7½% on the base."

The fairness of the method thus necessarily depended upon the margin of error in the computation of the rates so as to yield the basic return. If the margin were great, unfairness would result to the public in years of excess earnings, and to the Company in years of deficiencies. If, however, the margin were small, the Company would earn substantially the return at the allowed rate.

The Consent Decree did not assume to prescribe all the steps in the rate-making process. For example, the Consent Decree did not prescribe what should constitute additions to plant or what allowances should be made for materials and supplies, or for cash working capital, or what effect should be given to the various types of taxes. These matters were apparently left to the discretion of the Commission, just as they were under the statute, subject, of course, to the general rules of law pertaining to this subject.⁹³

The Consent Decree, however, did prescribe what allowances should be made for depreciation. In this respect, the Decree provided a method of treating depreciation which was not in accordance with the statute. To this extent, the Commission lacked capacity to enter into the Consent Decree. It may well be that the Commission did not like the provisions of Paragraph 16 of the statute. It, nevertheless, was under a duty to adhere to these provisions of the statute and to give effect to every part thereof. The result of applying the depreciation provision of the Consent Decree, rather than that of the statute, was entirely to the disadvantage of the consumers. Between 1925 and 1942, the overpayments by the consumers on account of this difference in the treatment of depreciation totalled over \$14,121,000.⁹⁴

In these circumstances, if the question as to retention or abandonment relates to the method set forth in the Consent

⁹³ Strangely, the Commission and the Company more recently regarded all the practices during the period of the sliding scale arrangement as having been incorporated in the Consent Decree.

⁹⁴ Formal Case No. 326, Tr. pp. 1450-71, and Exh. 62 therein.

Decree, the answer may be that the method should neither be retained nor abandoned, but should be modified in the following manner: (1) that the rate base should be the actual legitimate original cost, less a proper amount of depreciation, indicative of the present condition of the property; (2) that the rate of return should be computed upon the Company's legitimate capitalization, and (3) that all other elements entering into the computation of rates should conform to the facts and the applicable principles of law as of the present time. But, as will be seen later, the history of the Company and the application of the sliding scale arrangement have rendered even a depreciated original cost rate base impossible of application. It must, therefore, be concluded that the method of rate regulation set forth in the Consent Decree should be abandoned.

D. Sliding scale actually applied

At the time the Consent Decree was entered into, those engaged in public utility regulation were compelled to bow to the seeming requirement of Constitutional law that "fair value," greater than actual legitimate cost, must constitute the proper rate base. The sliding scale method was an "escape" from the traditional method of rate making. Even so, the rate base adopted was considerably greater than was warranted. However, soon afterwards the Supreme Court began to whittle away at the "fair value" doctrine, and the rate base should have been adjusted accordingly, until now it should have represented the actual legitimate original cost depreciated. The history of the sliding scale arrangement, as applied, is marked by (1) excessive earnings by the Company,⁹⁵ and (2) the use of misleading concepts to lull the public into thinking that their rights have been fully protected.

(1) *Excessive earnings*.—With the rate base of \$32,500,000 being some \$9,500,000 in excess of the actual investment in plant, and with an allowed rate of return of 7½% of this undepreciated rate base, the return would have been high enough, had the rates been properly computed to yield such a return. It was evident by the end of 1925, however, that the schedules

⁹⁵ Tr. p. 1827. •

of rates appended to the Consent Decree were in error by a large margin. The return earned was 9.59%, and the excess earnings were \$702,776. Did the Company file rates which in 1926 would yield a return of $7\frac{1}{2}\%$ on the new rate base less \$351,388? Having found that the excess profits were so great in 1925, did the Commission undertake to ascertain what rates for 1926 would yield a return of $7\frac{1}{2}\%$ of the new rate base less \$351,388? Quite the contrary. The rates adopted for 1926 yielded a return of 9.72%, and the excess earnings were \$800,587. And thus it was that in 1927 the rate earned was 9.22% and the excess earnings were \$698,500; that in 1928 the rate earned was 10.28% and the excess earnings were \$1,220,990; that in 1929 the rate earned was 10.34% and the excess earnings were \$1,360,837; and that in 1930 the rate earned was 10.71% and the excess earnings were \$1,583,624.⁹⁶ But these were not all the excess earnings under the sliding scale decree. To the above excess earnings for each of the years must be added one-half of the excess for the preceding year. In this view, the excess earnings during 1925 through 1930 totalled approximately \$8,560,000.⁹⁷

How, indeed, did it happen that the engineers and accountants for both the Company and the Commission arrived at estimates so far from the goal? The answer is that neither the Company's staff nor the Commission's staff made any attempt to arrive at rates which would yield a return prescribed in the Consent Decree.⁹⁸ Instead of applying their expert knowledge, they were guided by a formula of their own creation. What they really did was to compute rates which would have yielded in the preceding year the same gross revenue, less one-half of the excess earnings, and applied those rates to the succeeding year, on the assumption that the rate base, revenues, expenses, taxes, and the amount of energy sold would remain the same as

⁹⁶ Exh. 1, Sch. 1.

⁹⁷ In this connection it must be observed that any computations of excess earnings, upon facts other than those which actually took place, are bound to be problematical, for no one can tell what would have been the result, had conditions been different. The same observations hold with reference to computations of so-called "savings to consumers" due to the sliding scale arrangement.

⁹⁸ Tr. p. 723-4.

in the preceding year. Of course, it was a matter of common knowledge that these elements in rate making would not remain the same from year to year. It was known that the Company's plant and expenses would grow, that the community was growing, and hence the Company's revenues, and it was also a matter of common knowledge that a diminution in the charge per unit of service would result in a greater use of that service, and hence also in an additional increase in the Company's revenues.

Actually, the rate base increased from \$33,608,189 in 1925 to \$49,372,904 in 1930, the operating revenues increased from \$7,112,623 in 1925 to \$10,554,033 in 1930, while the operating expenses, including depreciation and taxes, increased from \$3,889,232 in 1925 to \$5,287,441. With the increase in revenues amounting to 48.4%, and the increase in income deductions amounting to 35.4%, the formula adopted was bound to result in unwarranted profits to the Company. It is no answer to say that the formula was based on static conditions, when, in fact, the conditions were not static.

How did all this escape public notice. The answer is simple. These rate determinations were made behind closed doors, through conferences between the Company and the Commission, rather than through public hearings.⁹⁹ Although the excessive earnings were very great, the Commission did not, on its own initiative, institute proceedings with the view of preventing excessive charges, i. e., those resulting in excessive earnings. It waited until there was a storm of demands for a public hearing, which was opposed by the Company.¹⁰⁰ A hearing was held in 1930. Here the method employed in computing rates was finally disclosed. The Commission found that the earnings were "excessive and unreasonable." A so-called rate reduction was ordered, but the method of computing the rate reduction remained the same. It was decided to

⁹⁹ It is interesting to note that in the course of the present hearing the President of the Company urged that the questions in this case be made the subject of a "conference" between the Company, the Commission, and the newly appointed People's Counsel (see Tr. pp. 3855-6, 3885-8; see, also, pp. 2294-2300.)

¹⁰⁰ F. C. No. 220, Tr. p. 6-11.

hold another hearing in May 1931, and the result of that hearing was to reduce the rate of return from $7\frac{1}{2}\%$ to 7% .

What appeared to be a victory for the consumers was really a great victory for the Company, for (a) the latter continued to enjoy excess earnings, (b) the formula which operated behind closed doors was written into the arrangement itself, and (c) the possible deficiency in earnings no longer served to counterbalance excess earnings made during the preceding years.

(a) Although the rates for 1931 were reduced, the excess earnings of the Company during that year were \$1,409,482. In 1932, they were \$1,059,341. During the depression years of 1933 and 1934, the Company earned \$757,837 and \$295,001 in excess of 7% . Then the rate of return was decreased to $6\frac{1}{2}\%$, but the earnings exceeded this amount by \$620,721 in 1935 and by \$986,152 in 1936. Again the rate of return was reduced to 6% , but the excess earnings in 1937 were \$1,436,458, in 1938 \$788,170 and in 1939 \$1,127,079. Then came the years of high war taxes, but the excess earnings were \$674,008 in 1940; in 1941 there is said to have been a deficiency of \$12,006, though there was no hearing or determination to that effect; in 1942 the excess earnings were \$620,819, and in 1943 the excess earnings were \$781,148.¹⁰¹

(b) This was only a part of the Company's victory in the 1931 case. The second part of the victory was more important. What was previously done behind closed doors, was now approved by order of the Commission, and thenceforth the questionable method of computing rates was applied openly. The order provided that if the excess earnings were not more than 1% of the rate base, the rates for the following year "*based upon the business done during the twelve months in which such excess occurred*" should be so adjusted that the gross receipts of the Company would be reduced by one-half of such excess. This marked a departure not only from the provisions of the Consent Decree, but also from all sound theory of rate making.

In accordance with this formula, it is assumed that if there is an increase in business on the part of a utility, such increase need not inure to the benefit of the consumers, although they are charged with all the expenses, depreciation and even all

¹⁰¹ According to Exh. 12, Sch. 1.

taxes pertaining to the increase in business. The assumption is fundamentally in conflict with the principle of rate making, that where the service is otherwise worth the charge paid for it, the maximum which a utility is entitled to is a fair return on its investment, and that the consumers are entitled to all the economies which flow from the fact that all of them, as a group, contribute to the revenues of the utility.

On the basis of the order issued in 1931, which amended the sliding scale decree, one-half of the excess earnings of each year is said to have been applied in reduction of rates for the succeeding year. But if there is anything left to the proposition that the consumers are entitled to benefit by the increase in business, then the rate reductions are not what they are said to be. They are a figure in a computation, but the aggregate amount paid by the consumers, even on the rate base of the preceding year, does not reflect the rate reduction said to have been applied. On the contrary, while the charge per unit of service was reduced, the rate of return paid for the entire service in the aggregate, showed an increase for the years 1925 through 1942.¹⁰²

(c) There was still a third aspect to the Company's victory in the 1931 case. The sliding scale arrangement was so amended that the method to be applied for an increase in rates in case of a deficiency in the earnings no longer served to counter-balance any part of the excess earnings. The 1931 order provided that the Commission shall "promptly increase rates," in a manner similar to that prescribed above for reduction of rates, so as to yield as nearly as may be 7% upon the rate base for the twelve months' period immediately preceding the date of the order effecting such changes in rates. The effect of this change was that while the reduction in rates should be merely a reduction in gross operating revenue, the increase in rates should constitute an increase in the net operating revenue. This made quite a difference. Taking the present proceeding as an example, the evidence shows that if the sliding scale formula were applied, the amount available for a reduction in rates is \$390,574, that is to say, assuming that in 1944 the

¹⁰² The results are tabulated in Exh. 15, marked for identification, but anyone can make the same computations with Exh. 1, Sch. 1, Col. 1; Exh. 1, Sch. 9, last column; and Exh. 1, Sch. 1, Col. 10.

revenues, expenses, taxes, etc. were the same as in 1943, and assuming no increase in business, the gross revenue would be approximately \$390,000 less than in 1943.¹⁰³ On account of the tax savings, the cost of this reduction to the Company would be approximately \$74,000. But if the figures presented by the Company are correct, and there has been a deficiency in earnings of approximately \$715,652¹⁰⁴ for 1943, then, according to the provision in the sliding scale arrangement, the rates must be so increased that the revenue would yield a return of 6%. This means that the cost to the consumers would have to be increased, not by \$715,632, but by approximately \$3,500,000.

(2) *Misleading concepts.*—One may indeed ask at this point, how is it that the sliding scale arrangement as applied in the District of Columbia is so generally favored? The answer lies in the word "advertising." The arrangement has been so publicized through the use of metaphorical language, "puffing," and misrepresentation, in public hearings and especially through the public press, that it is necessary to make an analysis of the terms used to show their fallaciousness.

(a) The sliding scale arrangement was "sold" to the public as a "profit sharing" plan, as a method whereby any excess earnings are "divided equally" between the Company and the consumers. "Profit sharing" is undoubtedly a good thing; therefore, the sliding scale arrangement must be a good thing. So thoroughly was this publicized that even as eminent an authority on rates as Charles W. Smith, Chief Accountant for the Federal Power Commission, who testified in this case, spoke of the great advantages of the sliding scale arrangement because it involved a division of excess earnings between the Company and the consumers.¹⁰⁵

From the words "division of excess earnings"¹⁰⁶ it is an easy step to the words "return of 1/2 of the excess earnings."¹⁰⁷ To

¹⁰³ Exh. 12, Sch. 1.

¹⁰⁴ Exh. 14.

¹⁰⁵ Tr. p. 1267.

¹⁰⁶ Comp. Tr. pp. 61, 63.

¹⁰⁷ This, until recently, was a current phrase in sliding scale discussion. As a matter of fact, the Consent Decree contemplated this very thing, when it provided that the Company, during any one year, should "absorb" one-half of the excess earnings of the preceding year. But that is not so in the sliding scale arrangement as it has been applied.

say that one-half of the excess earnings has been annually returned to the consumers, however, would be obviously false, for all of the excess earnings have been retained by the Company, and not one cent of it has been returned to the consumers.¹⁰⁸ Therefore, instead of saying that one-half of the excess earnings had been "returned" to the consumers, another phrase was added to make the concept more complicated, namely, "returned by way of rate reduction." Now the test of verification is no longer simple.

The phrase now used is "portion of excess earnings *applied* to rate reductions." No longer are excess earnings divided or returned, but only "applied."¹⁰⁹ And they are "applied" in a very limited sense, while the public, and even the Chief Accountant of the Federal Power Commission, are still imbued with the idea that there is some division of profits in this arrangement.

(b) Another phrase of advertising appeal is "savings to the consumer." It is not enough to add the amounts which have been "applied to rate reductions" from 1925 to 1942. This would show only \$8,393,000 over a period of 18 years. Therefore, the rate reductions are cumulated, and then added, that is to say, the first amount is added 18 times, the second 17 times, the third 16 times, etc., until the last amount is added only once. By this process, the "savings" to the consumers are said to be about \$90,000,000, which one of the witnesses testified,¹¹⁰ the members of the Federation of Citizens' Associations at their meeting could "feel in their pockets." Another method of computing the "savings" to the consumers is to multiply the total use of electricity between 1925 and 1943 by the rates which prevailed in 1924 and subtracting the revenue received by the Company. On this basis, the savings to the consumers are said to total some \$200,000,000, as testified by the same witness. He did not, however, say that the 60 or 70 delegates who attended the meeting could feel this sum "in their pockets," probably because \$200,000,000 is too large a sum to be taken to

¹⁰⁸ Tr. p. 686-7.

¹⁰⁹ At times the earnings are said to be "recaptured," though the Company holds on to them (Tr. pp. 2680-1).

¹¹⁰ Testimony of the Vice Chairman of the Public Utilities Committee of the Federation of Citizens' Associations (Tr. p. 767; see, also, Tr. pp. 18, 62).

any meeting of the Federation, even if it means only \$3,000,000 per delegate.

Various comparisons were made between the experience under this sliding scale arrangement with what has happened to electric companies serving other cities,¹¹¹ but it does not appear how great have been the savings to the people in those cities resulting from rate reductions which had taken place without a sliding scale arrangement. It was overlooked that "savings" so computed are not merely a function of rate reductions, but also of increases in population, increases in commercial and industrial developments, conditions of employment, and perhaps many other social and economic factors for which the utility is in no way responsible, but from which it has greatly benefited.¹¹²

(c) A great deal is accomplished by proclaiming that the "rate of return" is only $7\frac{1}{2}\%$, or 7% or 6%.¹¹³ Such rates are high enough. But this is not the entire story. The percentage of return under the sliding scale arrangement has not been applied to the Company's actual investment in plant, but to a considerable amount in excess. In 1925, the actual investment in plant undepreciated (on a weighted basis), plus allowances for materials and supplies and cash working capital was about \$24,342,000, but $7\frac{1}{2}\%$ was allowed on \$33,608,000, and the amount actually earned was \$3,223,000, which was $7\frac{1}{2}\%$ of approximately \$42,973,000. In the following year, the original cost rate base (plus materials and supplies and cash working capital) was about \$26,968,000, whereas the sliding scale rate base was about \$36,131,000, and the amount actually earned was \$3,510,000, which is $7\frac{1}{2}\%$ of approximately \$46,800,000. True, as time went on, the difference between the sliding scale base and the original cost rate base has diminished until it now stands at \$5,691,730.¹¹⁴ Accordingly, the difference between the "allowable" return and the actual return has also diminished. In 1942, the original cost rate base was \$94,628,000, whereas the sliding scale rate base was \$100,154,000, and the amount

¹¹¹ Exh. 3.

¹¹² Tr. p. 435.

¹¹³ Tr. p. 17, Exh. 1, Sch. 1, and comp. Exh. 52, Tables III a, b, c.

¹¹⁴ Tr. pp. 22, 25, 793-4.

earned was \$6,630,000, which was 6% of approximately \$110,500,000.

However, all this is definitely an understatement of what were the actual rates of return earned. Included in the rate base was an amount for materials and supplies not limited to those needed for repairs and maintenance, but also those used for new construction.¹¹⁵ These amounts ranged from \$483,174 allowed in 1925 to \$2,615,642 allowed in 1942.¹¹⁶ The record does not show by how much these amounts were excessive, except that for 1942 there was evidence to sustain an allowance of only \$1,263,920,¹¹⁷ and the record also showed that in years past the Commission promised that a determination of the proper amount to be allowed for materials and supplies would be made "at the next hearing," but such a determination was never made.¹¹⁸

Included in the rate base for each year was also an allowance for cash working capital. This ranged from \$398,727 in 1925 to \$1,158,466 in 1942. The amount allowed was 12½% of the operating expenses. Here also there was never a determination of the proper amount to be allowed for cash working capital, and the evidence in 1942 justified an allowance of only \$795,000. The evidence this year shows that nothing should be allowed for cash working capital.¹¹⁹

(d) It must not be overlooked that the rates of return discussed above are applied to an "undepreciated rate base" with only 4% of the depreciation reserve charged against expense. The very concept of "undepreciated rate base" is one of doubtful meaning or validity.¹²⁰ It stems from a hypothesis based upon an arithmetical equivalent to computations made upon a depreciated rate base. Starting with the proposition that a utility is entitled to earn a fair return on its property in its "present condition," i. e., in its existing state of depreciation,¹²¹

¹¹⁵ Tr. pp. 26, 819.

¹¹⁶ Exh. 1, Sch. 7.

¹¹⁷ Order No. 2564, pp. 67-70.

¹¹⁸ Order No. 1650, p. 2; see, also, Order No. 2564, p. 68.

¹¹⁹ Exh. 20, Tr. pp. 802-6, 820-857.

¹²⁰ Tr. pp. 2535, et seq.

¹²¹ Tr. p. 1271.

it is correctly pointed out that, in order to ascertain the amount of the property actually involved, one must deduct accrued depreciation from the original cost of the property. The difference, multiplied by the rate of return, yields the return. The next correct step in the reasoning process is that, if instead of applying the rate of return to the difference between original cost and accrued depreciation, one were to apply the rate of return first to the original cost without deducting depreciation then to the accrued depreciation, and then subtract the second product from the first, one would arrive at the same arithmetical result. The third correct step in the reasoning process is that where the rate of return earned is the same as the rate of return allowed, the same result is obtained, if the rate is applied to the original cost and the product of the accrued depreciation and the rate of return is added to the revenue or subtracted from the revenue deductions. These arithmetical equivalents hold true so long, and only so long, as none of the factors is varied. Then, for purpose of computation, it is proper to speak of an "undepreciated rate base."

However, when the rate of return allowed is one percentage and the rate of return earned another, or when the charge for depreciation is at a rate different from that earned, or when the depreciation accrued is a figure other than the depreciation reserve requirement, then the mathematical equivalence vanishes and with it also the meaning or validity of the concept "undepreciated rate base." What actually happens is this: If the rate of return earned on the so-called undepreciated rate base is 9% and only 4% of the depreciation reserve is charged to revenue deductions, the Company, in effect, receives an additional return at the rate of 5% on nonexistent property in an amount equal to the depreciation reserve; and if the depreciation reserve is less, for example, by some \$7,000,000 than the actual accrued depreciation, then by this method the utility is allowed a still additional return of 9% on \$7,000,000 of property which is no longer in existence. This is what has actually been the case under the sliding scale arrangement as applied. As Witness Kleinman aptly remarked: "* * * if there is any valid meaning to the phrase 'percent earned' the rate base

must have been something different than the rate base actually used * * *¹²²

(e) The allowance of a return on an undepreciated rate base, with a deduction of 4% of the depreciation reserve from revenue deductions, presents another illustration of misleading concepts. It is assumed that if the depreciated rate base is resolved into the various sources of capital, the weighted average cost of these various sources of capital will represent the allowed rate of return. Then, if the depreciation reserve should also be included as a source of capital costing 4%, the entire average cost would be somewhat less, and this new rate of return, applied to the undepreciated rate base, will yield the same return as the previous rate applied to the depreciated rate base.¹²³ So far so good.

But then it was testified by the Commission's Chief Accountant that it was proper to charge the depreciation reserve with 4%, because that has been "considered" in computing the allowed rate of return.¹²⁴ He could refer to no sources where such "consideration" could be found.¹²⁵ What he really meant was this: If the depreciation reserve were a sum loaned or invested by the public in the Company's plant, if the Company paid interest at the rate of 4% on this loan or investment, and if the property in the present condition plus the depreciation reserve equalled the cost of the property, then the resulting cost of capital would be a proper rate of return to be applied to an undepreciated rate base; and that when the Commission allowed a rate of return of 7½%, 7% or 6% on the undepreciated rate base, the result was the same as would have obtained had it allowed a higher rate of return on a depreciated rate base. Therefore, the allowed rate of return should be considered as having been higher than 7½%, 7% or 6%, and everything is

¹²² Tr. p. 2562.

¹²³ Exh. 26, Sch. 4, Tr. pp. 911, 917, 966-987; also Exh. 35 and Tr. pp. 1324-30.

¹²⁴ Tr. p. 971. As to the effect of the 4% on the rate of return, see Tr. p. 2478. See, also, Exh. 51 and 52, Tr. pp. 2479 et seq. for the meaning and effect of the 4% credit on the depreciation reserve and on the rate of return actually earned.

¹²⁵ Tr. p. 988-990.

squared with the proposition that a utility is entitled to a fair return on its property in its state of depreciation.

But there is one thing which is not squared. If the explanation given has basis in fact, and if by allowing a rate of return of $7\frac{1}{2}\%$, 7% or 6% the Commission actually meant to allow a higher rate, why did it not say so? Why was it necessary to represent the rate of return as being lower than it actually was?

(f) Another explanation current in justifying the sliding scale arrangement relates to the Company's earnings on their common stock and the dividends declared thereon.¹²⁶ Since it is established that in addition to paying all expenses and depreciation the consumers must support the Company's capital structure, it is always proper to inquire whether the Company is earning a reasonable amount on its capitalization. In the last analysis, this reduces itself to the question: What are the common stockholders' earnings on their investment?

The Commission introduced evidence to show that the earnings on the common stock equity decreased from 31.97% in 1925 to 9.89% in 1942, and that the average through these years was 14.44%. The evidence also showed that the dividends on the common stock equity (as if dividends are so declared) varied between 6.34% and 11.49% during these years, with an average of 9.15%.¹²⁷ The earnings and dividends thus computed compared favorably enough with an average for ten companies, which, in 1942 earned 6.42% on the common stock equity and declared dividends at the rate of 5.48% on their common stock equity, while PEPCo. earned 9.29% and declared dividends of 8.21% on the same basis.¹²⁸ However, the fact remains that the earnings on the par value of the common stock of PEPCo. varied between 43.3% and 75.1%, and the dividends varied between 14% and 65% per year during the period of the sliding scale arrangement.¹²⁹ The fact also remains that while the average dividends of the Companies for 1942 were 7.05% the dividends declared by PEPCo. in the same year were 34.50%.¹³⁰

¹²⁶ Tr. pp. 36, 70, 73.

¹²⁷ Exh. 2, Sch. 1.

¹²⁸ Exh. 3, Sch. 4.

¹²⁹ Tr. pp. 185-6.

¹³⁰ Tr. p. 189.

A question arose, therefore, as to what is the proper ratio to use as the measure of earnings or dividends: Should it be the common stock equity or the par value? It has been suggested that the former is the proper measure, because that represents the actual investment in common stock. But this is not the actual investment in common stock. The actual investment is what the Company received for its common stock. While the par value of the common stock up to June 1942 was \$6,000,000, the amount actually received by PEPCo. for the common stock did not exceed \$2,245,000,¹³¹ and, when in 1942 the common stock was increased by 30,000 shares, the actual investment in common stock did not exceed \$5,245,000. The dividends on the money actually invested were, therefore, at rates $2\frac{2}{3}$ times as much as the rates on the par value basis, until 1942. In other words, they were as much as 37 percent in 1925 and 42 percent in 1926; they were between 75 percent and 160 percent during the depression years; they were 173 percent in the years 1937 through 1939; they were 157 percent in the years 1940 and 1941, and 138 percent in the first part of 1942. When the actual investment in common stock was increased, the dividends in the latter part of 1942 were actually over 59 percent.

Measuring earnings and dividends by the common stock equity proceeds on the assumption that the stockholders are, in all circumstances, entitled to a return not only on the amount they actually invest in common stock, but also on the growth in the value of the common stock to which they have contributed nothing, but which has been contributed through excess earnings. It may well be that stockholders are entitled to earnings on the utility's past earnings in some instances, but not so in this case, as will appear later.

(g) It would take a volume to analyze, clarify and correct all the misleading concepts used to glorify the sliding scale arrangement as it has been applied. The mere fact that between 1925 and 1942 the Company's plant increased by \$71,721,834, with an increase in the depreciation reserve of about \$12,000,000, and only \$25,000,000 came from bonds, \$7,000,000 from preferred stock, and \$3,000,000 (only in the last six months of

¹³¹ Exh. 41, Tr. pp. 1632-53, 3183-84.

1942) came from common stock means that over \$24,000,000 in plant came from earnings, at the average rate of \$1,300,000 per year. If the return had been reasonable, this would hardly have been possible, even if the common stock had received very modest dividends. But this increase in plant has taken place after the common stock received \$42,195,000 or over 700%, or on the average of 38.8% on its par value; in fact, about 2,000%, or on the average of over 100% per year on the amount actually invested in common stock.

Resort, however, is had to comparisons with rates in other jurisdictions. Of what significance are the assertions and re-assertions that reductions in rates followed the adoption of the sliding scale arrangement, and, therefore, they were made because of the sliding scale arrangement?¹³² *Post hoc ergo propter hoc*. Granted that the rates in the District of Columbia are lower than elsewhere,¹³³ is that an indication that the rates here are as low as they should be, or is that an indication that the rates elsewhere are higher than they should be? Granted that even the sliding scale arrangement as applied has resulted in greater benefits to the consumers than rate regulation elsewhere, where the traditional method of rate regulation has been pursued, is this the proper criterion for determining whether the sliding scale arrangement should be retained or abandoned? The real criterion is the question whether the sliding scale arrangement as applied is a method of rate making which is as advantageous to the consumers as they are entitled to have.¹³⁴ No matter how advantageous the present arrangement may have been, the consumers are entitled to a more advantageous arrangement, if that can be accomplished still leaving the Company with a fair and reasonable return on its investment.¹³⁵ It is from the standpoint of this criterion that the disposition of the question must be considered.

In view of the above, it must be concluded:

¹³² Comp. Tr. pp. 45-9, 428-9, 476-482, 562-565, 1820; PEPCo. brief pp. 14-20.

¹³³ Exh. 3, Sch. 9; see, also, Tr. pp. 53, 56.

¹³⁴ Tr. pp. 86-7, 437-440, 1821.

¹³⁵ Tr. p. 2271-2.

(1) That the sliding scale method of rate regulation affords a means for keeping rates constantly at the level of reasonableness and if properly applied is of benefit to the Company and the public.

(2) That while the consent of the utility to such a method is desirable, it is not at all necessary; certainly the utility's consent thereto should not be purchased at a substantial cost to the public.

(3) That the sliding scale method embodied in the Consent Decree of 1924, requiring a property rate base, is no longer applicable because of the history of the Company and the manner in which the sliding scale arrangement has been applied. This will be discussed later.

(4) That the sliding scale arrangement as applied has resulted in excessive profits to the Company, hence in unjust and unreasonable rates; that the arrangement is based on erroneous assumptions as to rate making and on false and misleading concepts. Therefore, the present sliding scale arrangement requires modification in all of its elements, leaving only the principle of annual rate adjustment.

III. Modifications of the sliding scale arrangement

At the outset, it must be made clear that in the adoption or modification of a sliding scale arrangement or method of rate regulation, the utility should not be placed in a position less advantageous than it is entitled to under the law without such method or arrangement. On the other hand, the method adopted should not become a burden on the public greater than that imposed by the law. There is a zone of reasonableness between invasion of the rights of the utility and invasion of the rights of the public. Any method adopted must, therefore, operate within this zone of reasonableness.

For this purpose, it is necessary to determine what the Company is entitled to under the law. This calls for a discussion of (A) the rate base, (B) the revenues and expenses, (C) what would constitute a fair return, and (D) what method should be employed for a simple annual adjustment of rates so that the Company would at all times receive a reasonable return and the public would at all times pay reasonable rates.

A. The rate base

It has already been demonstrated that the Commission is not under any Constitutional or statutory requirement to base its rate determinations on the "fair value" of the property of the utility,¹³⁶ and that it may consistently with the requirements of the statute, base its rates on the Company's actual investment. It has also been demonstrated that the evidence of the Company as to the "fair value" of the property cannot be accepted because it is unreliable and leads to absurd results. The evidence shows that the "original cost" base has the advantage of being practical, that it is workable and readily applicable. It is fair to the investor, because the return is related to the actual investment; it is fair to the consumer, because he pays the reasonable cost of capital represented by the actual investment in plant.¹³⁷ Such a property rate base should be employed, if it is otherwise warranted. If not, the rates should be based upon the capital invested in the utility service.

(1) *Property rate base.*—For a *property* rate base, it is necessary (a) to determine the original cost of the plant, (b) from which should be subtracted the accrued depreciation, and (c) to which should be added a reasonable amount for working capital.

(a) *Original cost of plant.*—The cost of the Company's plant may be easily determined.¹³⁸ Upon the reclassification of accounts made in 1941, as of December 31, 1936, most of the write-ups in the plant accounts were eliminated. There may still be some small write-ups,¹³⁹ but until these are eliminated, the present book cost of plant may be regarded as fairly representative of actual cost. The cost of plant for the year 1943 for rate-making purposes, is the cost of plant as of December 31, 1942, on an unweighted basis, i. e., \$96,421,616, plus the

¹³⁶ At best, the testimony proves the invalidity of "fair value" in rate making, for with this utility already making huge profits, the employment of a "fair value" rate base merely accentuates the unreasonableness of the return so arrived at.

¹³⁷ Tr. pp. 1830-3.

¹³⁸ Tr. pp. 1880-2.

¹³⁹ See, e. g., Order No. 2564, pp. 61-64; Tr. pp. 1494-5.

net additions for 1943 on a weighted basis, i. e., \$2,698,678 or a total of \$99,120,294.¹⁴⁰

The fact that the gross investment in plant is \$99,120,294 does not mean that this is the base on which a return should be allowed. Part of this amount has not been invested by the Company, but by the consumers. These are contributions in aid of construction (\$2,482,705) and desposits for extensions (\$71,953),¹⁴¹ or a total of \$2,554,658. This amount should be deducted from the gross investment in plant, because the Company is entitled to a return on its own investment, not on that contributed by the consumers. The "undepreciated rate base"¹⁴² is, therefore, \$96,665,636.

(b) *Depreciation*.—A great part of the testimony was devoted to the question of depreciation. It is clear from all the witnesses who testified in this proceeding that the treatment of depreciation under the sliding scale arrangement as it heretofore existed was defective. It was testified by the President of the Company in the 1943 hearing, and by the Commission's witnesses in this hearing, that the Company's depreciation reserve is at present inadequate.¹⁴³ The main objection stressed was that the limitations on the depreciation reserve and on depreciation expense were improper.¹⁴⁴ Little concern was expressed about the fact that the provisions of the statute had not been followed. On the contrary, according to the testimony of some of the witnesses, it would appear that there was a justification for not having followed the provisions of the statute, because it was a hodge-podge, or was inartistically drafted,¹⁴⁵ or because its meaning is obscure.¹⁴⁶ It was overlooked that, after all, the policies of Congress, not of engineers and accountants, must guide the Commission. True, legislation often requires interpretation, but it is a fundamental rule that wherever pos-

¹⁴⁰ Exh. 45.

¹⁴¹ Exh. 1, Sch. 6.

¹⁴² The term "undepreciated rate base" is here used merely to designate a figure in computation.

¹⁴³ Tr. pp. 200, 1204, 1361, 2200.

¹⁴⁴ Tr. pp. 1193-4, 1346-8, 2568.

¹⁴⁵ Tr. pp. 1229, 1282.

¹⁴⁶ Tr. pp. 1338, 1341.

sible every word of the provision must be given effect.¹⁴⁷ We are not at liberty to disregard any part of the statutory mandate. If possible, the statute must be interpreted in the light of the growing knowledge we have about depreciation; if that is not possible, if the present theories and methods of treating depreciation are in conflict with the statute, the will of Congress, rather than the will of engineers and accountants, must nevertheless prevail. In view of the fact that for the past nineteen years little or no attention has been given to the statutory requirements, a detailed analysis of Paragraph 16¹⁴⁸ of our statute is now in order. We must go back to the law.

Paragraph 16 provides:

(i) "*That every public utility shall carry a proper and adequate depreciation account.*"—This is said to have been inartistically drafted, because accountants do not use such language. Yet, this provision is not difficult to understand. One fundamental fact lies at the basis of any concept of depreciation. Any physical property used in any operation has a limited service life. As the property is put into service, it is subjected to wear and tear, decay, inadequacy, obsolescence, and public requirements.¹⁴⁹ This process of diminution in service life is known as depreciation.¹⁵⁰ The extent to which the property depreciates in any given year is referred to as the "annual accrual for depreciation," and the extent to which the property has depreciated from the time it was first put into use

¹⁴⁷ *MacDonald v. Thompson*, 305 U. S. 263, 266, and cases cited therein.

¹⁴⁸ Quoted in note No. 53, *supra*.

¹⁴⁹ Tr. p. 1178.

¹⁵⁰ See Tr. pp. 1177-9. In *Lindheimer v. Ill. Bell Tel. Co.*, 292 U. S. 151, Chief Justice Hughes defined depreciation as follows (p. 167):

"Broadly speaking, depreciation is the loss, not restored by current maintenance, which is due to all the factors causing the ultimate retirement of the property. These factors embrace wear and tear, decay, inadequacy and obsolescence. Annual depreciation is the loss which takes place in a year. In determining reasonable rates for supplying public service, it is proper to include in the operating expenses, that is, in the cost of producing the service, an allowance for consumption of capital in order to maintain the integrity of the investment in the service rendered. The amount necessary to be provided annually for this purpose is the subject of estimate and computation."

is generally referred to as its "accrued depreciation" or "depreciation reserve requirement."¹⁵¹ The statute requires that the depreciation account be both proper and adequate. The word "proper" relates to the manner of building up the depreciation reserve. By the word "adequate" is meant, of course, that the accrued depreciation shall represent as nearly as it can the expired part of the service life of the property.

(ii) "*The Commission shall ascertain and determine what are the proper and adequate rates of depreciation of the several classes of property of each public utility.*"—First, it must be noted that the statute speaks of the rates of depreciation for the several classes of property, not rates of depreciation for the various units of property¹⁵² nor a rate of depreciation for all of the property. Evidently it excludes such a method as has been embodied in the sliding scale arrangement¹⁵³ where one rate is

¹⁵¹ Tr. pp. 1180-2, 1417, 1490.

¹⁵² The provision excludes rates of depreciation based on units of property, for it was evident at that time, as it is now, that depreciation based on units of property is too laborious a task, and the final outcome is not apt to be any more accurate than the treatment of property by various classifications. (Tr. pp. 1188, 1559-60.)

¹⁵³ In the course of the hearing (Tr. p. 2289), counsel for the Commission argued that the Supreme Court, in *Vinson v. Washington Gas Light Co.*, — U. S. —, 88 L. Ed. 646, decided March 27, 1944, sustained the validity of the sliding scale depreciation method under the statute. I do not so read the opinion delivered by Justice Roberts. In illustrating that the Commission heard all the evidence offered by the Administrator, and that it said that it had weighed it, Justice Roberts said: "The Administrator urged that the straight line method of depreciation embodied in the sinking fund plan [he meant in the sliding scale plan] must be discarded in favor of a sinking fund method under the force of decisions of this court, a position unsupported by our cases, and evidence was offered to show the result which would ensue the substitution." While Justice Roberts made no reference to the cases, he undoubtedly meant the long line of cases which reiterate the proposition that the Court does not sit as a board of revision, but only to enforce constitutional or statutory rights. *Los Angeles Gas and Electric Corp. v. Railroad Commission*, 289 U. S. 287, 304. As will appear in the text presently, the statute does not require the Commission to follow one theory of depreciation rather than another.

True, great stress was laid by counsel for the Administrator on the proposition that the theory followed by this Commission was in conflict with the decision of the Supreme Court in *Federal Power Commission v. Natural Gas Pipe Line Company*, 315 U. S. 575, 593. But that case merely held that the Court would not disturb the Federal Power Commission's determination in that regard. It did not follow that the Court would have required that

applied to the rate base, including both depreciable and non-depreciable property, materials and supplies currently used up in operations, and cash working capital.¹⁵⁴ While it is competent for the Commission under this provision to arrive at a "composite rate" of depreciation for the entire property of the utility, such composite rate must be based on the rates of depreciation for the various classes of property. Nor does it mean that the Commission may arbitrarily set rates of depreciation for the various classes of property, for the statute requires that such rates should be "ascertained and determined," which necessarily implies that the rates must be fixed upon competent evidence and upon a reasonable classification. It may be reasonable to regard all turbo-generators as one class for this purpose, but it would certainly be unreasonable to regard turbo-generators as belonging to the same class with office furniture, and it would be still more unreasonable to regard all of the property, of whatever character, as belonging to the same class for the purpose of determining the over-all rate of depreciation.

Second, it must be noted that the statute speaks of rates of depreciation. The use of the term "rate" implies some uniformity in the expiration of the service life of the particular prop-

Commission to adopt this method had it chosen to compute depreciation on a different theory. The decision of the Supreme Court in the *Natural Gas Pipe Line Case* had little application. The Commission's action had to be tested by the provisions of the statute itself. In *Re Washington Gas Light Co.*, 46 P. U. R. (N. S.) 1, 43-44, 57; In *Re Potomac Electric Power Co.*, 48 P. U. R. (N. S.) 437, 494-7; see, also, Order No. 2682, pp. 64-66.

In this view, all that the Supreme Court held in *Vinson v. Washington Gas Light Company* was that the Court would not require the Commission to pursue one theory of depreciation rather than another. It had no occasion to, and it did not, pass on the question whether the statutory provisions in Paragraph 16 had been fully complied with. Nor can one visualize any occasion for the Court to pass on this question by way of *ratio decidendi*, rather than *dictum*, unless upon appeal from the Commission's order it were shown that unreasonable rates resulted specifically from an erroneous application of this statutory provision and have not been compensated for otherwise.

The mere fact that the scope of judicial review is limited by the doctrine of administrative finality, however, does not mean that the Commission is absolved from its duty to apply the statute. Herein, rather than in the expansion of the scope of judicial review, lies the safeguard against *administrative absolutism*.

¹⁵⁴ See Tr. p. 1269.

erty considered. The method of arriving at the rates of depreciation is apparently left within the discretion of the Commission, subject to the standard contained therein, namely, that the rates be "proper and adequate," which is explained in the next sentence of the provision, namely: "*These rates shall be such as will provide the amounts required over and above the expense of maintenance to keep such property in a state of efficiency corresponding to the progress of the industry.*" It was with reference to this provision that one of the witnesses suggested that the statute was without meaning.¹⁵⁵ On the contrary, this sentence is full of meaning. The statute was drafted at a time when obsolescence was considered separate from depreciation. While depreciation was regarded as a diminution in service life due mainly to physical causes, obsolescence was regarded as a diminution in service life due to the fact that there is progress in the arts, that the invention of new machinery and the economies which flow therefrom accelerate the retirement of old equipment rather than permit continuation of its maintenance. Later, obsolescence came to be regarded as one of the elements of depreciation. The provision quoted merely provides that obsolescence be included in the rates of depreciation. It must also be observed in this connection that the words "expense of maintenance" are not used in the technical accounting sense of the costs currently incurred in maintaining the property in working condition, but the expense involved in maintaining the integrity of the investment in the service rendered.

Aside from these limitations, the theory to be pursued in ascertaining and determining what are the proper and adequate rates of depreciation, as was stated, was left to the Commission. Three principal methods were developed by expert witnesses in this case: The method of observation to ascertain the percent condition of the property, the method of arriving at depreciation by forecasting retirements, and the method of straight-line depreciation. These will be discussed presently.

(iii) "*Each public utility shall conform its depreciation accounts to such rates so ascertained and determined by the Com-*

¹⁵⁵ Tr. pp. 1338, 1427-8.

mission.”—This provision makes the determination of the Commission self-executing. When the Commission, upon competent evidence, ascertains and determines what should be the rates of depreciation, it is not necessary to issue an order requiring the Company so to treat its depreciation accounts. This is required by the statute. The law does not contemplate that book depreciation be one thing, and the Commission's determination be another thing. On the contrary, as soon as the Commission makes a determination, the depreciation accounts must be adjusted accordingly. This, however, does not forever freeze ¹⁵⁶ either the Commission's determination or the depreciation account, for the statute further provides:

(iv) *“The Commission may make changes in such rates of depreciation from time to time as it may find necessary.”*—Here the statute contemplates that the Commission keep itself informed concerning the service life of the various classes of property. It may happen that in a period of great progress in the industrial arts, the rates may have to be increased. On the other hand, the new acquisitions to plant may be so constructed as to withstand greater use, in which case the rates should be decreased. It may be disclosed by later studies that the prior studies involved an error in computation or in the estimate of service life. The rates should then be changed, provided the Commission finds it necessary.¹⁵⁷ Here, again, the statute requires that the new findings of the Commission be properly reflected in the books of the Company, for it is provided:

(v) *“The Commission may also prescribe rules, regulations, and forms of accounts regarding such depreciation which the public utility is required to carry into effect.”*—While the statute leaves this function of the Commission discretionary, there is a duty imposed on the utility to carry the rules, regulations, and forms of accounts into effect when prescribed by the Commission. Here, indeed, it may also be fairly maintained that the word “may” is equivalent to “shall”; that it is mandatory on the Commission to prescribe such rules, regulations and forms of accounts, if it is to comply seriously with the other mandatory provisions of this statute.

¹⁵⁶ Comp. Tr. pp. 1213, 1280.

¹⁵⁷ Comp. *United States v. Baltimore & Ohio R. R. Co.*, 293 U. S. 454, 462-3.

(vi) "*The Commission shall provide for such depreciation in fixing rates, tolls and charges to be paid by the public.*"—This is the requirement that the depreciation accounts shall be consistently applied.¹⁵⁸ Not only is there no room for one depreciation account for "book purposes" and another for rate purposes, but the accrued depreciation and the annual accruals for depreciation must be based on the same rates of depreciation for the various classes of property, ascertained and determined by the Commission. As has been indicated, the statute does not prescribe any particular method of computing depreciation, but it is difficult to see how with this provision there is any room for argument that the utility may have recouped as much as fifty per cent of its investment in a piece of property through allowances for depreciation, yet have as much as ninety per cent of the investment left for the purpose of computing rates to be paid by the public, as has been testified by one of the Company's expert witnesses.¹⁵⁹

(vii) "*All moneys in this fund may be expended in keeping the property of such public utility in repair and good and serviceable condition for the use to which it is devoted, or invested, and, if invested, the income from the investments shall also be carried in the depreciation fund.*"—To an accountant careful of his technical phraseology this may appear like a contradiction in terms. How, indeed, can accrued depreciation be a "fund," when a fund is on the asset side of the balance sheet, while depreciation reserve is on the liability side?¹⁶⁰ The answer is that Congress does not bow to the practices or nomenclature of the accountants. Words of a statute must be interpreted not in their technical sense, but in accordance with ordinary usage.¹⁶¹ It has long been the usage to speak of depreciation funds as meaning the funds represented by accrued depreciation.¹⁶² Even in this proceeding no less an authority than Dr. Sonbright employed this language,¹⁶³ and the Com-

¹⁵⁸ Tr. pp. 1340, 1920.

¹⁵⁹ Tr. pp. 3707-11, 3722-3, 3725-31.

¹⁶⁰ Tr. p. 1229.

¹⁶¹ *United States v. Fisher*, 2 Cr. 358, *Caminatti v. United States*, 242 U. S. 470.

¹⁶² See, also, Treasury brief pp. 49-50.

¹⁶³ Tr. pp. 1839, 2109-10.

pany's Comptroller, in explaining the components of the rate base, included the depreciation reserve,¹⁶⁴ and he referred to the "depreciation moneys" as being "funds."¹⁶⁵

It was testified that a "fund" meant a liquid fund, or an investment in securities, a trust fund, or a sum of money or securities one can trace, or money invested in negotiable securities,¹⁶⁶ the object, apparently, being to find some technical excuse for avoiding the application of the statutory provision. But this is a construction so strict that it would not be warranted even in the application of a criminal statute.¹⁶⁷ This is a remedial statute and must be construed liberally.¹⁶⁸ In addition, this very statute requires that it be interpreted and construed liberally in order to accomplish its purpose.¹⁶⁹ In this view, the term "fund" must mean the aggregate amount of money or property represented by the accrued depreciation.

The depreciation fund¹⁷⁰ may either be expended for repairs and maintenance or it may be invested. Here, again, wide discretion is vested in the Commission and perhaps also in the Company, so long as the latter's discretion is not limited by the Commission's rules and regulations. Ordinarily, the depreciation funds are not used for repairs and maintenance, but to acquire new property to take the place of the diminution in service life and subsequent retirement of old property. However, it may happen that the depreciation, accrued in accordance with the above requirements of the statute, may grow too large, or that there may be a stoppage in the development of

¹⁶⁴ Tr. pp. 589-90, 591-2—"Sources of funds."

¹⁶⁵ Tr. pp. 592, 652.

¹⁶⁶ Tr. pp. 1226, 1229, 1344-5, 1366, 1406-7, 1432.

¹⁶⁷ *United States v. Shreveport Grain and Elevator Co.*, 287 U. S. 77, 82, and cases cited therein.

¹⁶⁸ *United States v. Padelford*, 9 Wall. 531.

¹⁶⁹ PAR. 92. That the provisions of this section shall be interpreted and construed liberally in order to accomplish the purposes thereof, and where any specific power or authority is given the commission by the provisions of this section the enumeration thereof shall not be held to exclude or impair any power or authority otherwise in this section conferred on said commission. * * *

¹⁷⁰ The term is used advisedly, with the word "depreciation" as an adjectival noun and meaning the assets equivalent in dollars to the depreciation requirement.

the community and further expansion of plant may not be necessary. In such circumstances, it may be proper for the Company, under the direction of the Commission, to expend part of these funds in repair and maintenance. In such circumstances, however, the Company's repair and maintenance would not be charged to operating expense. Throughout all the years under the sliding scale arrangement, however, the rate-payers did pay for all the repairs and maintenance expenses; therefore, the question of charging repairs and maintenance to the depreciation account is academic, and one must look to the only alternative under the statute, namely, the investment of the depreciation fund.

Here, also, the question how the depreciation funds should be invested is left within the discretion of the Commission. It is to be expected that during any period of growth in the operating plant, the Commission, charged by law to protect the public interest, would require the Company to invest such funds in the plant, rather than in some other enterprise, unless the investment in another enterprise would yield greater returns than the utility operations and greater than the cost of borrowed capital to the Company. Obviously, if the return on funds so invested is less than the return on the investment in the Company's own plant, both the Company's and consumers' interest would demand that the investment of the depreciation funds be made in the Company's own plant. Sound business judgment would require it, and this is what has actually been done.¹⁷¹

It is conceivable that during a static period, when there is no need for further investment in plant, and it would not be advisable to charge the funds with costs of repairs and maintenance, the Commission may require the Company to invest a part of the depreciation funds in some securities, perhaps for a temporary period until further investment in plant becomes necessary. This is also within the Commission's sound discretion. But this is also academic, because the depreciation funds have actually been invested in the plant.

¹⁷¹ Tr., pp. 364-6, 680.

Therefore, we come to the limits of the discretionary power granted. The funds having been so invested, the earnings on the funds *had* to be carried in the depreciation fund. The effect of this provision in terms of rate making is significant. Between rate determinations, the depreciation fund continues to grow (unless during any part of such periods, the operating revenue is not sufficient to meet all expenses of repairs and maintenance, in which case the Company may draw upon the depreciation fund, or unless the retirements of plant are great). At the next rate determination, the net balance in the depreciation reserve thus built up is deducted from the plant account in order to arrive at the depreciated rate base, and the latest rates of depreciation, applied to the undepreciated rate base, are treated as the annual depreciation expense. The results are not "accurate," but the margin of error, in such circumstances, falls well within the deviations which occur in all the elements of rate making when rates, found to be just and reasonable in one year, are assumed to continue to be so until the next rate determination.

Where rates are determined annually, however, the application of this statutory provision contemplates: First, if any part of the depreciation fund is used for repairs and maintenance, such amount would not be allowed as operating expense; second, if the depreciation fund or any part thereof is invested in securities, the operating revenue would be increased, or operating expenses would be decreased, by the actual proceeds of the depreciation fund, not by some arbitrary percentage like 4%; and third, if no part of the depreciation fund is used for repairs and maintenance, and if all the depreciation funds are invested in the Company's plant, then the operating revenues would be increased, or operating expenses would be diminished, by the amount of the additions to the accrued depreciation at the rate of return earned on the property of the plant. Mathematically, this is equivalent to computing rates on the depreciated rate base, provided the accrued depreciation and the rates of depreciation are consistently arrived at, and provided further that the accrued depreciation is representative of the depreciation requirement.

This, in my judgment, is the meaning of the statutory requirements as to depreciation, which must be given effect. These statutory provisions have not been given effect during the life of the sliding scale arrangement. Instead of ascertaining and determining the proper rates of depreciation for the various classes of property, arbitrary percentages were applied not only to the depreciable property, but also nondepreciable property and even to hypothetical property (like the allowance for cash working capital). Instead of crediting the revenue with the actual proceeds from the depreciation fund, only 4% of the depreciation reserve balance was applied. In great measure, it was because of these failures to follow the statutory requirements that the Company has been unjustly enriched.¹⁷²

In this reexamination of the sliding scale method of rate determination, we must go back to the statute and follow its requirements. The problem is not merely to find the accrued depreciation and annual depreciation, but also to adopt a method which could be applied for the future, consistently with the statutory requirements. Let us examine, therefore, the three main methods discussed at the hearing.

Observed depreciation.—With the evidence relating to the “fair value” of the Company’s property rejected, the evidence pertaining to depreciation upon the method used in that connection must also be rejected. While the witness testified that his estimate of accrued depreciation was not arrived at by a detailed observation of the property, to arrive at its percentage condition, he, nevertheless, stressed that an inspection of the property was made by himself and by a force of engineers operating under his supervision. A bird’s-eye view cannot be considered competent evidence to sustain a figure of \$22,153,000.¹⁷³ But even if detailed observations had been made and the percentage condition of the property so ascertained, I think that this method of arriving at accrued depreciation should be rejected. The method of observed depreciation stems from an analogy which is entirely inapplicable. If one were concerned with one piece of property subject to diminution in service life

¹⁷² In re *Natural Gas Pipe Line Co.*, 2 F. P. C. 218, 230.

¹⁷³ Tr. p. 3149, but see PEPCo. brief, p. 31.

on account of one simple factor, it would be easy to determine the depreciation and rate of depreciation of that property by mere observation. As additional factors influencing the diminution in the service life of the property are added, and as other units of property of the same kind are added, the task of determining the percentage depreciation through observation becomes more and more complicated. As more complicated units of property are substituted, the amount of depreciation becomes no longer a matter of observation, but of study, tests, experiments and estimates on the part of engineers. At this point the assumptions of simplicity lose their meaning in the midst of this complex undertaking.¹⁷⁴ "Observed depreciation" becomes an impossibility even if the factors influencing the retirement of property were the only variables. Here is added the "personal equation" of the engineer making the estimates, and the variations due to this factor are probably greater than those of the depreciation factors themselves. In other words, observed depreciation is generally subject to the same infirmities of unreliability as attach to the estimates of fair value of the property, and should not be adopted in the application of the statute now or for the future. It is no mere accident that somehow the claims for annual accrual for depreciation made on behalf of utilities are always far greater than would be necessary to produce the observed depreciation requirement. In other words, the method of observed depreciation lacks that element of consistency which lends meaning to the relationship between depreciation accrual and accrued depreciation.¹⁷⁵

Retirement forecasts.—The Company's main witness on this question presented a different method of arriving at depreciation,¹⁷⁶ namely, by forecasting the requirements of property for a period of ten years. While rejecting the straight-line method of depreciation as being based on the assumption of uniformity in the expiration of service life of property due to all factors, he adopts his own service life figures based only

¹⁷⁴ Yet it is on these assumptions of simplicity that depreciation was considered in terms of observed condition of property based on engineering estimates. See, for example, *McCardle v. Indianapolis Water Works*, 272 U. S. 400, 416; see, also, Tr. p. 1408.

¹⁷⁵ Tr. pp. 1219, 1222-3, 1437, 1824, 2104, 2457-8.

¹⁷⁶ Tr. pp. 2977-3035, 3366-3433.

on such physical factors as wear and tear, decay, etc. These figures are long-term normal lives, as long as 200 years, at any rate extending beyond the scope of experience.¹⁷⁷ Upon these estimated figures he superimposes an element of prophecy based on managerial judgment and purporting to embrace such functional causes of retirement as obsolescence, inadequacy, Government requirements, changes in plant, and others.¹⁷⁸ The personal equation entering into these estimates for the future is bound to make the result highly speculative, and obvious deviations from these estimates are justified by the term "managerial judgment."

The witness thus estimates the amount of property which will be scheduled for retirement within the next ten years, and the remainder of the property is classified as not scheduled for retirement during that period. Upon the above-stated ratios (if they may be properly so called) he arrives at the amount of depreciation which will have been accrued for both scheduled and unscheduled property. After subtracting an amount which he calls an adjustment for customers' contributions to plant, he adds the amount of "reserve for unforeseen retirements."¹⁷⁹ It is significant that this amount of reserve for unforeseen retirements is treated by the witness as being a "judgment figure." In reality, it is only the arithmetical difference between the book depreciation reserve and the estimated amounts necessary for the retirement of scheduled and nonscheduled property. In other words, if there is any significance to the figure, it is really a showing by how much the managerial judgment is in error, provided the depreciation reserve is representative of the extent to which the property has actually depreciated. If, however, the book depreciation reserve falls far short of the depreciation requirement, as seems to be the case here, then the figure for reserve for unforeseen retirements must be very much greater, and hence a much greater error in the managerial judgment. However, the witness himself asserted that the depreciation reserve is not rep-

¹⁷⁷ See Exh. 54, where only 6.4% of depreciation is attributed to physical causes, and the remainder to functional causes.

¹⁷⁸ Comp. Tr. p. 1201.

¹⁷⁹ Exh. 55A.

representative of accrued depreciation. Therefore, it is not known how erroneous this judgment figure is, and the witness could suggest no test which might be applied to review the managerial judgment.

The net result is that the testimony of this witness contains no evidence as to the accrued depreciation representative of the present condition of the property. He does, however, compute the annual accrual for depreciation for 1944 on the same basis as his estimate for retirements for the next ten years, namely, on the two components, the first being an estimate of long-term life due to physical causes, and the second an estimate of a combination of all the functional causes. The personal equation entering into these estimates for the future is bound to make the result highly speculative, especially since the functional causes, which, according to the witness, are responsible for 93.6% of the retirements, are a reflection of the managerial judgment, not subject to any effective test. The witness further demonstrated what would be the accruals necessary for the next ten years in order to maintain the present ratio of the present book reserve for depreciation to the depreciable property, and what would be the corresponding reserves at the end of the 10-year period,¹⁸⁰ if the annual rates were increased by $\frac{1}{10}\%$ or by 1%. Here again the major test is managerial judgment.

Since the amounts of both accrued depreciation and annual accrual for depreciation are important elements in rate determination, the sum and substance of this testimony is that, to this extent, rate making should be left to the judgment of the Company.¹⁸¹ This would be an unwarranted surrender of the Commission's functions and duties, because the statute requires that the *Commission*, not the Company, shall ascertain and determine the proper and adequate rates of depreciation for the several classes of property. Furthermore, the phrase "rates of depreciation" imply a uniformity in depreciation. While the numerous causes of depreciation may act with a

¹⁸⁰ Exh. 86-58.

¹⁸¹ Of course, new constructions and expenses are also left largely to managerial judgment. This, however, is hardly an argument in support of further divestiture of the Commission's regulatory functions.

high degree of nonuniformity, the statute requires the Commission to impute a uniformity which can be done by averaging the effects of the causes on the many items of property included in each class. The greater the number of items of property, the less is the margin of error in this averaging. But where the rate is made to depend on managerial judgment as to what property should be retired, then the uniformity of depreciation depends largely on the uniformity of that judgment; if there is no effective test of the margin of error in that judgment, there can also be no test of uniformity in the rates of depreciation so arrived at.

Straight-line depreciation.—This brings us, therefore, to the third method of determining accrued depreciation and annual accrual for depreciation, namely, the straight-line method. By this method each class of property is assigned an average service life.¹⁸² The average service life is the result of past experience, hence verifiable, rather than estimates for the future which are not verifiable. Of course, the best way of arriving at an average service life for a class of property is through a continuing study of service lives, modifying the results from time to time in accordance with the most recent data.¹⁸³ In the absence of such a study, however, one must accept as tentative the average service life estimates of those who had to deal with similar classes of property on a large scale. In other words, it must be assumed, in the absence of evidence to the contrary, that the service lives of the various classes of property of this Company are substantially the same as those of other companies.¹⁸⁴

It is upon such estimates of service life that the accrual rates in Exhibit 31 have been computed. This is the best evidence available. In criticism of this evidence, the Company's main witness on depreciation stated that this method should not be followed blindly, which, of course, is correct. No method should be followed blindly, but the solution to any errors which may be found in these accrual rates does not lie in the substitution of a factor of unknown variability like "man-

¹⁸² Tr. pp. 1184-5.

¹⁸³ Tr. pp. 1211, 1475-6.

¹⁸⁴ Tr. pp. 1197-9.

agerial judgment." It lies in further study of service lives, upon verifiable facts.

The comparative simplicity of this method of depreciation is appealing.¹⁸⁵ With the book cost of depreciable property readily available, and the average service lives of the various classes of property ascertained, it is a simple matter of arithmetic to arrive at the annual accrual for depreciation. In this case, the composite rate of depreciation is 2.6969% as of the end of 1942, and the accrual for depreciation for that year is \$2,528,104. The accrual for depreciation for 1943 is \$2,600,896.95 on an unweighted basis, and \$1,114,912 on a weighted basis. With the accrual rates and cost of depreciable plant now available, one need know only the average years in service of the several classes of depreciable property. This is also a verifiable fact. With the latter figures available, it again becomes a simple matter of multiplication to ascertain the reserve requirement or accrued depreciation. In accordance with Exhibit 31, the average years in service is 9.6159, and the reserve requirement, or what the accrued depreciation should be is \$23,903,571, as of December 31, 1942.¹⁸⁶

Since the depreciation reserve as of the end of that year is \$16,667,165, or over \$7,000,000 less than the figure yielded by Exhibit 31, it is evident that the present reserve is too low, that is, it falls short of representing the condition of the property as of the present time. On the other hand, the witness who introduced Exhibit 31, the Chief Accountant of the Federal Power Commission, who is a well recognized and outstanding authority on public utility accounting, himself thought that the reserve requirement of \$23,903,671, as of the end of 1942, was too high.¹⁸⁷ By how much he thought it was too high, he did not know, but he based this conclusion on the fact that in any actuarial study, where an average life is determined, once a number of years have elapsed, the remaining life is advanced above the average. Therefore, as to the items of property now in

¹⁸⁵ Tr. pp. 1188-1193.

¹⁸⁶ Tr. p. 1200. See, also, p. 2571, where Mr. Kleinman calculates the depreciation requirement as of the end of 1943 to be \$25,591,558.

¹⁸⁷ Tr. p. 1272. This is definitely an illustration of a difference between principle and practice. Tr. p. 1491. See, also, Tr. pp. 2131-9.

plant, the average life is greater than that reflected in the accrual rates; hence the accrual rates should be lower; hence the accrued depreciation should also be lower.¹⁸⁸ This analogy to insurance rates is erroneous. As in the case of life insurance, a study could be made which would yield the service life expectancies of the various classes of property already in service for one year, two years, etc., up to the maximum years, and rates of accrual could then be computed on that basis. But this would no longer be the "straight-line" method of depreciation favored by the witness. It does not at all follow that the accrual rates would be the same. On the contrary, it may well be that defects in manufacture or construction will accelerate the end of the service life in the first few years to such an extent that the accrual rates, when averaged, will be entirely different.

There is another fault to this analogy to life-insurance rates. These are determined for the insured of a given age upon his own life expectancy; the insurance is not written for groups of persons in being and of those yet to be born. To say that the depreciation requirement is too high, because when property has already reached the age of 9.615 years its average life expectancy is no longer 37.08 (100 divided by the accrual rate of 2.6909%) years, but something more, involves an assumption that there will be no continuity between old and new plant, and that when the present property is worn out the entire plant will expire.¹⁸⁹ The straight-line method of computing depreciation must proceed on the assumption that, with the continuation of the plant, new acquisitions will be made with similar average service lives, but also with the same probabilities of infant mortality. Therefore, it must be assumed that the various classes and subclasses of property will have their average service lives, and that the value of each piece of property (cost being the measure of value) will diminish proportionately during this average life. It may well be that a given piece of property already in service will increase the average, but at the same time the average will be restored by the fact that another piece of property will perish in its infancy.

¹⁸⁸ Tr. pp. 1273-5, 1530-3, 1620-1.

¹⁸⁹ Comp. Exh. 40, Tr. pp. 1615-20.

The cost of the property, the average service life, and the number of years in service are the facts which may be in dispute and must be ascertained. Once these are ascertained, however, the annual accrual for depreciation and the depreciation requirement are also ascertained. As has been aptly brought out in the hearing, there may be a dispute whether 2 (rather than some other number) should be multiplied by 3 (rather than some other number), but when 2 is multiplied by 3, the result must be 6.¹⁹⁰

Other exhibits were introduced showing lesser reserve requirements. Exhibit 32 gives effect to the depreciation rates in Exhibit 31 for the years 1925 through 1942, but assumes that the depreciation reserve as of the end of 1924 correctly represented the depreciation requirement as of that date.¹⁹¹ On this basis the adjusted reserve balance at the end of 1942 is \$19,367,785. It is evident, however, that this computation lacks consistency, which is essential to the computation of any depreciation reserve. Exhibit 36¹⁹² shows a somewhat different accrual for depreciation due to some differences in the estimated service life of the various classes of property and with a deduction of salvage from the total annual accrual. Here the rates of accrual do not give consideration to salvage, and, therefore, are not as representative of the service life of each class of property as those in Exhibit 31. On the basis of these accruals for the years 1925 through 1942, but with the depreciation reserve as of 1924 assumed to be the correct reserve requirement, the accrued depreciation is computed as being \$20,619,288. This exhibit is, therefore, subject also to the same infirmity as Exhibit 32. In Exhibit 38,¹⁹³ the rates of depreciation arrived at in Exhibit 36 are applied to the additions for each of the years since 1922. The total estimated reserve accrued on this basis is \$22,562,018, but here the rate is applied to the entire plant, including nondepreciable property and construction in progress.

Upon a consideration of these exhibits it must be concluded

¹⁹⁰ Tr. pp. 1534-1540.

¹⁹¹ Tr. pp. 1209-12.

¹⁹² See Tr. pp. 1349-55.

¹⁹³ See Tr. pp. 1359-1363.

that the depreciation reserve requirement, as of the end of 1942, was \$23,903,571, as shown in Exhibit 31. But now the question arises what use should be made of this figure. If this is the depreciation requirement, it means that the depreciation reserve, \$16,667,163, is short by \$7,246,408, and the depreciation reserve should be adjusted by this amount by a charge to surplus. The Chief Accountant for the Federal Power Commission did not think this should be done. His reasons, however, indicate that at this point he departs from his function as an accountant and assumes the role of a moralist, for his conclusions are based on what he calls "equitable considerations."¹⁹⁴

It was a strange consideration of "equity" which entered into this case. Evidently, the depreciation reserve has been inadequate for a great many years. This means that while the Company has not received sufficient annual amounts for depreciation expense as such, it has received returns on the difference between the depreciation requirement and the depreciation reserve, which it should not have received. Now the witness says in effect that it would be "inequitable" to put a stop to further profits resulting from this difference of over \$7,246,000. If it is considered that the depreciation requirement represents the expired life of the plant, his testimony is to the effect that "equity" would require that the Company should continue receiving a return on \$7,246,000 of property, which is no longer in existence. If the rate of return were 5%, as he assumed in another part of his testimony, this means that the consumers should from now on indefinitely continue paying \$362,390, which with income taxes thereon (at the present rate of 40%, assuming that the Company would not have to pay excess profits taxes) amounts to a charge against the consumers of over \$600,000 per year.¹⁹⁵ This is the consequence of the witness' motion of what is fair and equitable.¹⁹⁶

This consequence, according to his testimony, is counter-balanced by the consideration that, since consumers must pay amounts sufficient to cover cost of operation, reasonable annual

¹⁹⁴ Tr. pp. 1214, 1278, 1281, 1520-5.

¹⁹⁵ Tr. pp. 1590-5, 2106.

¹⁹⁶ Tr. p. 1246.

depreciation, and a reasonable return on the property, and the Commission, in years past, limited the amounts which the Company could recoup by way of depreciation expense, the Company should not be "penalized" by an adjustment of depreciation reserve.¹⁹⁷ But his reason is not better than the result, for it lacks reality. There is no "penalty" involved in putting a stop to unjust enrichment.¹⁹⁸ Furthermore, the Company could have insisted on a computation of rates of depreciation in accordance with the requirements of the statute. Instead, it entered into an "arrangement" with the Commission,¹⁹⁹ which arrangement resulted in insufficient recoupment of investment, but also in excess earnings which may be estimated to have been in excess of \$14,000,000. Therefore, the Company is still some \$7,000,000 to the good on the question of depreciation alone. This, according to the witness, does not enter into the "equities" of the case. Nor does the fact that, aside from this, the Company enjoyed fabulous returns. Apparently, the entire equitable consideration reduces itself to mere nomenclature. The great profits which enabled the Company to declare dividends of as much as 65% (or 173%, if computed on actual investment in common stock) per year after payment of all expenses, taxes, interest and other fixed charges, and which at the same time enabled the Company to build up a surplus in excess of \$25,000,000 during the life of the sliding scale arrangement,—all of these facts vanish into thin air, merely because the amounts denominated as "depreciation expense" were less than what they should have been.²⁰⁰

Dr. Bonbright testified that in an ordinary case, where a company has built up a reserve, however inadequate when tested by modern standards, but has nevertheless fully met the tests of adequacy under the rules and regulations which have prevailed, he would not adjust the depreciation reserve to reflect the depreciation actually accrued. But where the Company for many years enjoyed rates of return on an undepreciated rate base well in excess of the 4% interest on the depreciation

¹⁹⁷ Tr. p. 1511; but comp. Tr. pp. 1504-6.

¹⁹⁸ Tr. pp. 1839-40, 2140.

¹⁹⁹ Tr. p. 1606.

²⁰⁰ See, also, Tr. p. 1423.

reserve, he did not consider it an ordinary case.²⁰¹ He apparently had some qualms about letting the consumer continue to pay a return on property no longer in existence. Nevertheless, he also avoided giving a direct answer to the question whether the depreciation reserve should be increased by a charge to surplus. At one time he suggested that such an adjustment of surplus should not be made; at another time, that the matter should await a judicial determination; at still another time he suggested that the Commission might make the necessary adjustment and even welcome a test case.²⁰² But all these suggestions are really beside the point. They may have a bearing on the policy of rate regulation, but not on the questions of fact to which the witness must address himself.

The so-called "equities" in the case, which in the light of the facts are entirely on the side of the consumers, have really little bearing on this case, if it is considered—what is it on which the consumers must pay and on which the Company is entitled to earn a fair return? Both Dr. Bonbright and Mr. Smith testified that the return should be based on the actual cost of the property. Surely this does not mean that the return should be based on cost new, no matter what part of the service life had expired, but on the property in its depreciated condition.²⁰³ The value of any method of determining depreciation lies in the extent to which it is also determinative of the present condition of the property. If the depreciation requirement in Exhibit 31 is representative of the expired life of the plant as of December 31, 1942; and the most reliable evidence here shows that this is so, then equity or no equity, the property rate base is the cost less this amount, not cost less some other amount, be it the book reserve, sliding scale reserve, or anything else.

Nor is this an example of a "retroactive" treatment of depreciation, as has been erroneously suggested.²⁰⁴ A retroactive treatment would result if moneys collected in the past were now recovered through adjustments in depreciation. Whether such a treatment of depreciation would or would not be justified is

²⁰¹ Tr. pp. 1846-7.

²⁰² Tr. pp. 1843-5, 1847, 1987, 2081-2, 2108, 2122-3.

²⁰³ *Knorrville v. Knorrville Water Co.*, 212 U. S. 1, 10.

²⁰⁴ Tr. pp. 1244, 1596-7, 1846, 2081-2.

another question. I am not at all impressed with the idea that everything retroactive is unjust or unreasonable. Some retroactive measures are and others are not. The injection of the term "retroactive" in this connection only serves to becloud the issue by an appeal against some imagined wrong. There is nothing, however, either unjust or retroactive about ascertaining the present condition of the property with a view of determining the fair return thereon for the future. The fact that in the determination of the present condition it is necessary to draw upon the facts of the past imports no retroactivity. So, also, evidence pertaining to the service life of properties of the utility and arrive at different rates of accrual and at different average years in service than are shown on Exhibit 31 and should readjust the depreciation requirement to be applied for the future, this would not be a retroactive readjustment.

In view of the above, it must be concluded that the depreciated property rate base of 1943 must be \$71,547,153, computed as follows:

Original cost of property	-----	\$96, 665, 636
Depreciation to December 31, 1942	----- \$23, 903, 571	-----
Average net increase—1943	----- 1, 114, 912	25, 018, 483
	-----	-----
Cost less depreciation, 1943	-----	71, 547, 153

(3) *Working Capital*.—To the depreciated cost of the property should be added a reasonable amount for working capital, sufficient to cover an amount necessary for current materials and supplies and cash working capital.

(a) *Materials and supplies*.—Both the Commission's witness and the Company's witness computed the allowable amount to be \$2,562,581 for materials and supplies, being the average monthly balance of the Company's stores and presumably the average amount necessary to have on hand in order to carry on operations. The facts pertaining to this item are the same as in the 1943 rate case. These stores are not segregated as between property to be used for repairs and maintenance or for routine constructions on the one hand, and property to be used for major construction on the other.²⁰⁵ Nor is there any indica-

²⁰⁵ Tr. p. 384.

tion that all of the property in the stores is segregated between that which is used and useful and that which may be carried from year to year without any use at all in the service to the public. The amount allowed is a book figure. It will serve no useful purpose to repeat all that was said about allowances for materials and supplies in my dissent last year,²⁰⁶ especially about the necessity of making such allowances only upon competent evidence. It is interesting to note, however, the attitude of the Chief Accountant of the Federal Power Commission, who, when asked whether a segregation should be made between stores held for construction and stores held for maintenance, answered that no distinction should be made. His reason was that if construction material is excluded, then "interest during construction" must be allowed, and that this would be the worse of the two evils.²⁰⁷ Little consideration was given to the propositions that allowance of interest during construction is of questionable propriety, that, in any circumstances, such interest is allowable only for the period of construction, not for any period during which the property may be in the Company's stores, and that funds raised for construction through the issuance of securities are already paid for through rates which must be calculated to support the Company's capital structure.

However, in view of the state of the record with reference to this question, and in view of what will appear about "cash working capital," the amount of \$2,562,581 may be included as part of the rate base.

(b) *Cash working capital*.—It has also been the practice to include in the rate base an amount for "cash working capital." This amount is often based upon analogies and hypotheses having little relation to the facts of the particular case. It is correctly assumed that when a utility first starts operations, it must have a cash working sum of money with which to meet its expenses before the revenues begin flowing in. Then, analogously, it is assumed that when a company is in full operation it will continue to be in need of such a fund. The latter assumption is based on a further assumption that when the reve-

²⁰⁶ Order No. 2564, pp. 67-70.

²⁰⁷ Tr. pp. 1952-3.

nues do come in, the money belongs to the utility to do with as it pleases; it may, if it so desires, distribute all profits as dividends immediately, in which case there would be no cash left with which to carry on the business; the Company would then have to borrow funds, and, therefore, should be allowed an amount for cash working capital. This is a very unrealistic analogy. Aside from all the costs and difficulties which would be involved in such a preposterous way of carrying on business, it is wrong to assume that revenues as they come in belong to the stockholders, rather than to the corporation itself, which must use the funds for the purpose of carrying on the business.

This reasoning by analogy has given way to the proposition that if there is a lag between the receipt of revenue and the payment of bills by the Company, then the dollar-days in the lag measure the amount of cash the Company needs as a working capital fund to carry on its business. Theoretically this is correct; in practice this is not what has actually been done. Throughout the life of the sliding scale arrangement it has been arbitrarily assumed that the lag would be 45 days, and, therefore, the Company was allowed 12½% of its expenses as cash working capital. Last year the lag was actually computed.²⁰⁸ The Commission, however, did not follow that computation, but regarded the 45 days lag as being imbedded in the sliding scale arrangement.²⁰⁹ The result was that instead of allowing \$795,000 for cash working capital, the Commission allowed \$1,158,466.

In this proceeding, it developed that if in the computation of the lag taxes are included as operating expense, then there is no lag at all. On the contrary, the revenues themselves, without any cash working capital, furnish the Company with a working fund of some \$351,000 per year over and above funds necessary to meet all expenses, including taxes.²¹⁰ The Commission's Chief Accountant, therefore, arrived at the conclusion that no cash working capital should be allowed. It is not suggested that the excess of \$351,000 should be deducted from the rate base, but there certainly is no reason why in these cir-

²⁰⁸ Order No. 2564, pp. 64-67.

²⁰⁹ Tr. p. 383.

²¹⁰ Exh. 20.

cumstances a hypothetical cash working fund should be added to the rate base upon which a further return should be earned by the Company.

The Chief Accountant for the Federal Power Commission had a different view of this matter. He agreed that the \$351,000 should not be deducted from the rate base, but, he thought that the computation was too precise and that the Company should be allowed something for cash working capital, though there was no evidence upon which such an allowance should be made.²¹¹ I do not think we can be so free to deal with other people's money. However, in view of the fact that an allowance for working capital is made in the sum of \$2,562,581 for "materials and supplies," an amount obviously greater than what the Company is entitled to, there certainly is no reason why an additional sum should be added for "cash working capital."

On this basis the original cost rate base, including an allowance for working capital, should be \$71,547,153 plus \$2,562,581, or \$74,109,734.

(2) *Capital investment rate base.*—Ordinarily, the rate base should be the Company's property in its present condition of depreciation, excluding, of course, that part of the property which was contributed by the public. The elimination of \$2,482,705 from the original cost of plant, as contributions in aid of construction, or for extensions, suggests the question whether there are other contributions by rate payers on which it would be unfair to require them to pay a return to the Company, namely, contributions which now constitute the "earned surplus" in the Company's plant. If a utility is entitled to a return on its investment, not on any part of the investment made by the public, the question arises whether a utility is entitled to a return on its earned surplus. Is the Company entitled to earnings not only upon its investment, but also upon its earnings? Should a utility be permitted to capitalize its earned surplus?

The arguments in favor of allowing a return on earned surplus may be summarized as follows: Earned surplus results

²¹¹ Tr. pp. 1940-1, 1949-52.

from the fact that not all of the earnings are distributed as dividends to the stockholders, for had the corporation distributed all the earnings, there would have been no earned surplus; a corporation which does not distribute all of its earnings as dividends could do so and, at the same time, require the stockholders to make capital contributions and to issue stock therefor, in which case the same result would have been accomplished as in the case of capitalization of earned surplus; common stockholders are entitled to all the earnings in excess of fixed charges and other obligations, and when they receive only part of the earnings as dividends, they, in effect, plow the remaining part of their earnings back into the business; they thus invest part of their earnings into the business and are, therefore, entitled to a return on this investment.

These arguments in favor of capitalization of earnings, it will be noted, are based on premises which bear little relation to the realities of sound business management and on legal criteria which are not entirely correct. First, a corporation cannot distribute all of its earnings as dividends. Sound business judgment requires the retention of part of the earnings in surplus account, for otherwise the capital of the corporation might be endangered. In the case of a public utility corporation, such an unsound business practice as the distribution of all earnings as dividends may call for immediate action on the part of the regulatory agency to limit the amount of dividends. Second, a corporation cannot always distribute all its earnings, and, at the same time, ask for capital contributions. There are altogether too many obstacles in the way of such a fantastic procedure. Cost of financing and tax consequences alone would prevent it. Third, as a legal proposition, it is not true that common stockholders are entitled to all the earnings of a corporation after payment of fixed charges and other obligations. They are entitled only to such dividends as are declared by the directors of the corporation. Only in rare instances may stockholders compel the declaration of dividends.

There may be equitable considerations in favor of capitalization of earned surplus where common stockholders had not had sufficient dividends in the past, and the earnings were retained in the business for necessary reasons beyond their control.

Such instances, however, are rare. Capitalization of earned surplus is not usually a problem with utilities which earn a low return and deprive the stockholders of modest dividends. At any rate, these considerations are not present in the case of this Company, and, therefore, it is not necessary to decide whether the "equities of the case" would require the inclusion of earned surplus in the rate base. The problem of capitalization of earnings usually arises where the earnings have been excessive and the dividends quite sufficient. Since a public utility is not entitled to excessive earnings, its common stockholders are not entitled to excessive dividends.²¹² Therefore, they certainly are not entitled to have excessive earnings, left after normal dividends, capitalized so that they might earn dividends upon the excessive earnings.²¹³ *A fortiori*, they are not so entitled, if the dividends themselves have been excessive.

A more conservative view is to exclude earned surplus from the rate base only when such earnings had been attended by some form of irregularity.²¹⁴ The reasoning behind this view may be stated as follows: In the absence of evidence to the contrary, the presumption of regularity supports governmental action; ²¹⁵ therefore, rates fixed by public authority must be regarded as "reasonable" and as the rates to which the utility was entitled, though they in fact resulted in excessive earnings. Where, however, the rate-making process is attended by irregularity, like concealment, misrepresentation, gross neglect or fraud, then the presumption of regularity does not hold,

²¹² *Bluefield W. M. & Improv. Co. v. Pub. Service Comm.*, 262 U. S. 679, 692; *United Railways v. West*, 280 U. S. 234, 251; *Dayton-Goose Creek Ry. v. United States*, 263 U. S. 456, 481.

²¹³ See e. g. *Re Bay State Rate Case*, P. U. R. 1916 F. 221, 258, the Massachusetts Commission said: "Additions and betterments paid for out of earnings offset depreciation and protect investment, but form no part of it." See, also, *Re Farmers & Merchants Teleph. Co.* (Neb.) P. U. R. 1918 F. 283, 289; *Logan v. Bismarck Water Supply Co.* (N. D.), P. U. R. 1923 B, 450, 497-501; *Re Mondovi Teleph. Co.* (Wisc.) P. U. R. 1923 B, 319, 322; *Re Southern California Edison Co.* (Cal.) P. U. R. 1921 D 65, 73-4; *Re Readsburg Tel. Co.* (Wisc.) 7 P. U. R. (N. S.) 389, 395-6. In *Louisiana R. R. Commission v. Cumberland Tel. & Tel. Co.*, 212 U. S. 414, 425, the Supreme Court held that excess depreciation was not transferable to surplus, because that would result in capitalization of earnings. See, also, Tr. pp. 2710-2.

²¹⁴ *Ill. Com. Comm. v. Public Service Co.*, 4 P. U. R. (N. S.) 1, 45.

²¹⁵ *United States v. Chemical Foundation*, 272 U. S. 1, 14-15.

and earned surplus resulting from such rates cannot be regarded as earnings to which the utility was entitled, but as involuntary contributions on the part of the ratepayers.

What must be regarded as the law governing this case? Two separate and distinct rules point to the conclusion that PEPCo. is not entitled to earnings on its earned surplus; (a) the policy of Congress embodied in Paragraph 75 of the statute; and (b) the fact that the Company's earned surplus resulted from excessive earnings attended by irregularity.

(a) Paragraph 75 of the Public Utility Law provides:

Par. 75. That no public utility shall declare any stock, bond, or scrip dividend or divide the proceeds of the sale of any stock, bond, or scrip among its stockholders.

In enacting this provision, Congress was not dealing merely with matters of form. If all Congress intended was that no stock dividends were to be issued by public utilities, then there would have been no need for the second part of the provision forbidding the division of the proceeds of the sale of any stock among the stockholders. The latter part of the provision is indicative of a Congressional determination that this provision should not be circumvented.

Dividends are declared out of earnings. What is left of the earnings after distribution of dividends constitutes the earned surplus. The more conservative practice is to declare dividends out of current earnings and to have the earned surplus act as a safeguard of the common stock, so that in case the current earnings are not sufficient to declare reasonable dividends, the deficiency may be made up from the earned surplus, provided it is in the form of liquid assets. Nothing of this practice is prohibited by Paragraph 75. This provision assumes, however, as it must, that if the current earnings are sufficient for reasonable dividends, there is no need to draw upon the earned surplus; and if the earned surplus is not in the form of liquid assets, but is part of the operating plant, then the declaration of dividends out of surplus becomes impracticable.

If it is considered that the ratepayers must support the capital structure of a utility corporation, there is another principle which operates to limit dividends to the standard of reasonableness. Reasonable rates are such as would produce revenue

sufficient to pay all operating expenses, depreciation, taxes, interest and other fixed charges, *reasonable* dividends and "something" to be passed to surplus.²¹⁶ If the rates produce a revenue which yields excessive dividends plus something to add to surplus, then it must follow that the rates are excessive and, therefore, unlawful. It follows, therefore, that Paragraph 75, read in connection with Paragraph 2, means that if the dividends are excessive, a duty rests upon the Commission so to adjust the rates as to prevent excessive earnings, to limit the declaration of dividends to comply with the standard of reasonableness and to limit the earned surplus to one which would be necessary to safeguard the common stock. The allowance of earnings which would permit the declaration of excessive dividends and to accumulate a large earned surplus is, therefore, not only contrary to Paragraph 2, but also to the policy behind Paragraph 75.

But what is to be done, if the dividends are sufficient and the earned surplus is large, despite the above-stated policies? The provision of Paragraph 75 then operates to prohibit the capitalization of this surplus. The public utility may not issue stock, bonds or scrip dividends. In other words, it may not raise equity capital out of earned surplus,²¹⁷ which capital the ratepayers would be required to support. It follows, therefore, that the allowance of a return upon the earned surplus as if it were common stock, is a circumvention of Paragraph 75. This is exactly what is happening when the return allowed is computed not merely upon the common stock, but upon the common stock equity, including the earned surplus.²¹⁸

That the allowance of a return on common stock equity is a circumvention of Paragraph 75, was aptly brought out by a question asked by the Chairman when the Chief Accountant of the Illinois Commerce Commission testified about the application of the prudent investment method of rate regulation to this utility: ²¹⁹

²¹⁶ *United Railways v. West*, 280 U. S. 234, 251-2.

²¹⁷ Compare the evidence of the Company's witness Dunn, who testified that the Company was raising equity capital through earned surplus, Tr. pp. 3464, 3477-9.

²¹⁸ Tr. pp. 1024-6.

²¹⁹ Tr. p. 2922.

Chairman FLANAGAN. Mr. Kleinman, assuming that were adopted and that the present surplus has been built up under an arrangement approved by the court after annual hearings held by a lawfully-organized commission and the company said, we are sorry you placed us in this position. We have \$29,000,000 in surplus and do not get any return on it, so we might as well distribute it.

We have not got the cash, so we will issue some bonds to raise the cash. What might that do to the company and to the consumers of the District of Columbia?

The answer is simple. The Company would be limited to declaring *reasonable* dividends on the amount actually received for its common stock, and the consumers would be relieved from paying a return on property which they themselves had built up through excessive charges. The more significant part of the question, however, lies in its premise. If the Company were to sell bonds and distribute the proceeds to its stockholders, it would act in direct conflict with the express provision of Paragraph 75. Whichever way one turns, whatever methods one may seek to adopt to avoid this statute, the conclusion is inescapable that just and reasonable rates, under the Public Utility Law, cannot allow a return on earned surplus.²²⁰

(b) However, let us suppose that Congress was concerned only with this form of capitalization of earnings, that is, through declaration of stock dividends, and that it intended to forbid circumvention of this provision only through the distribution of proceeds from the sale of stock, but that it did not intend by this provision to forbid earnings upon earnings. In other words, let us suppose that Congress had never enacted Paragraph 75 into law. Still, the rules must prevail that if the earned surplus was the result of excessive earnings attended by some form of irregularity, it should be excluded from the rate base. That the earnings have been excessive, has already been demonstrated. Here the irregularities were abundant. They spell violation of law by the corporate system of which PEPCo. is an integral part, with the knowledge and acquiescence of the Com-

²²⁰ Tr. p. 1028.

mission, and gross neglect in the application of the statute by the Commission with the cooperation of the Company.

It has already been told, how, in violation of the Anti-merger Law, North American acquired the stock of WRECo., and, thereby, acquired control of operating utilities in the District of Columbia, including PEPCo. At first, while the acquisitions were made indirectly and secretly, they were, nevertheless, within the knowledge of the Commission.²²¹ When, toward the end of 1922, the Executive Secretary sought an explanation about these acquisitions, directing the attention of the syndicate members to the provisions of the Anti-merger Law,²²² and the officers of North American sought to ascertain the reason for this inquiry, they were apparently assured by one of the Commissioners that the Secretary's letter had been sent "in error."²²³ The syndicate members wrote that the stock was held merely for individual investments, not for North American, and according to advice of Counsel, refrained from using North American letterheads.²²⁴ Later, in 1926 and 1927, when the acquisitions become known, and there was great demand for disclosure, the Commission, on two occasions, requested their general counsel for an opinion as to the legality of North American holdings, and the question was dodged on both occasions.²²⁵ Still later, in 1929, when one of the Commissioners wrote a memorandum to the effect that both he and the General Counsel thought the acquisitions unlawful, the memorandum was suppressed by being marked N. F. P. (not for publication).²²⁶ In the Commission, the control which North American exercises over the local utilities has been regarded as an accomplished fact without regard to the law.

All this merely illustrates, as Counsel for the intervener maintained in introducing Exhibit 74, that from 1922 to the present time the North American Company and its subsidiaries conspired to violate and violated the Anti-merger Law, and

²²¹ Exh. 74, Sch. 2.

²²² Exh. 74, Sch. 3.

²²³ Exh. 74, Sch. 1, p. 22.

²²⁴ Exh. 74, Sch. 3.

²²⁵ Exh. 74, Sch. 4 and 6.

²²⁶ Exh. 74, Sch. 7.

that this was within the continuous knowledge and acquiescence of the Commission from the time of the first acquisitions to the present time. Counsel for the intervener also maintained that the sliding scale arrangement and the excessive profits resulting therefrom were part and parcel of the same conspiracy and violation of law. His reasoning seems to be that the motive behind the actions which constituted this conspiracy and violation of the Anti-merger Law was to obtain huge profits from the operations of the electric company which was part of this corporate system; that the same motive prompted PEPCo., as part of this corporate system, to enter into the sliding scale arrangement; and that this motive or intent must be inferred from the fact that year after year such profits were obtained and were retained by the Company and passed on to the other corporations in the form of dividends. Therefore, Counsel for the intervener maintains, there was a continuity of motive and action between the violation of the Anti-merger Law and the violation of the Public Utility Law.

This presents a difficult question of evidence, whether Exhibit 74 shows an unbroken chain of events connecting the excessive profits earned under the sliding scale arrangement with the violation of the Anti-merger Act by this corporate system. It does not appear, however, that it is necessary to pass on this question, for it is sufficient, for the purposes of this case, if there is evidence to show that the same attitude which the Commission entertained toward the violation of the Anti-merger Law has also obtained toward allowing excessive earnings to PEPCo. and its distribution of such earnings to the other members of the corporate system. I think that the evidence does bear out the same attitude, and that this is sufficient to prove that the excessive earnings earned by PEPCo. were attended by irregularity.

It is enough to recall the testimony of the President of PEPCo. that shortly after the adoption of the sliding scale decree of 1924, the then Chairman of the Commission and the Assistant Engineer Commissioner, who was active in the promulgation of that decree and in its application, told the President of the Company that they did not care how much profit the Company made, so long as there were rate reductions every

year.²²⁷ This epitomizes the sliding scale arrangement as applied. This is sufficient evidence of gross neglect as of that time, for such an attitude is not compatible with the determination of just and reasonable rates, which must be limited to a fair return on the Company's investment.²²⁸ That this gross neglect continued may be seen from the comparison of the consent decree as promulgated and the consent decree as applied. The procedural phases of the history of the sliding scale arrangement have been sufficiently covered in my dissent in the 1943 electric rate case.²²⁹ The statutory requirement that the rates shall be just and reasonable, read in the light of the law pertaining to public utility regulation, required the Commission to establish rates yielding a fair return warranted by the insignificant risks and uncertainties involved in this enterprise,²³⁰ rather than permit returns which were greater than those yielded by highly speculative enterprises.²³¹ It was only because the dividends were increased gradually year by year; rate adjustments under the sliding scale arrangement were made behind closed doors; the formula followed was entirely different from that contained in the so-called "Consent Decree" which required PEPCo. each year to absorb one-half of its excess earnings made in the previous year; the statutory provisions as to depreciation were disregarded; and the virtues of the sliding scale arrangement were publicized through false and misleading appeals, such as "profit sharing" and "returning excess earnings by way of rate reductions" when not a single cent of the excess earnings was actually returned, that between 1925 and 1930 the dividends rose from 14 percent to 24 percent, and, at the same time, the earned surplus increased from \$2,021,737 as of the end of 1924 to \$17,375,611 as of the end of 1930.²³²

²²⁷ Tr. p. 197, 232, 658-9.

²²⁸ See cases in note No. 212 *supra*; see, also, Tr. p. 2820.

²²⁹ Order No. 2564, pp. 47-56.

²³⁰ The Company enjoys a monopolistic position (Tr. pp. 2584-96); its largest customer is the government whose nonpreferential bills total about \$5,000,000 per year (Tr. pp. 1722 et seq.); the territory it serves has an increasing and financially more stable population (Tr. pp. 2323 et seq.); its risks are small even as compared with other electric utilities (Tr. pp. 2585 et seq.)

²³¹ *Bluefield W. W. & Improv. Co. v. Public Service Commission*, 262 U. S. 679, 692.

²³² Exh. 2, Sch. 1.

No matter how effectively facts are suppressed, the truth will float to the surface. The public became cognizant of the immense profits made by PEPCo. which had undertaken to render public service at fair and reasonable rates. Demands were made upon the P. U. C. to hold a hearing. This was resisted by PEPCo. A hearing was held, and the Commission found that the "rate of return yielded by the existing sliding scale is excessive and unreasonable".²³³ By this time it was well established law that where the return is unreasonably high, so also must be the rates.²³⁴ By this time, also, the Supreme Court decided the United Railways case,²³⁵ where the fair return was defined in terms of financial needs for sound business management, namely, that the rate of return must be sufficient to pay all the expenses of operation, set aside the necessary sums for depreciation, payment of interest and *reasonable* dividends and "something" to be passed to the surplus account.

The Commission did not undertake to establish fair and reasonable rates which would yield a return sufficient to meet operating expenses, depreciation, interest, *reasonable* dividends, and "something" to be passed on to surplus. It resorted to palliatives. It reduced the basic rate from 7½ to 7 percent, as if the basic rate of return meant anything more than a mere figure of computation in a formula,²³⁶ and it reduced the rates by small amounts which, however, yielded returns permitting PEPCo. to declare dividends at the rate of 26 percent in 1931, 28 percent in 1932, 30 percent in 1933, 38 percent in 1934 and 42½ percent in 1935, and, during this period, the earned surplus rose from approximately \$17,375,611 at the end of 1930 to \$26,987,031 at the end of 1935. The nation, during these years, was shaken by an economic catastrophe. Banks closed, business was on the rocks, and the wells of commerce went dry. But PEPCo. and its affiliates, WRECo. and North American enjoyed a period of great prosperity at the expense of the United States Government and the people of the District of Columbia.

²³³ Order No. 919.

²³⁴ *Dayton-Goose Creek Railway Co. v. United States*, 263 U. S. 456, 483.

²³⁵ *United Railways and Electric Co. v. West*, 280 U. S. 234, 251-2.

²³⁶ See Re: *Washington Gas Light Co.*, Order No. 2682, issued November 8, 1943, p. 72.

In 1935, demands were renewed for a determination of reasonable rates. Instead of responding to this call, the Commission overruled these requests, stating that it would consider these matters "when the investigations are completed." It has become part of a game in this Commission to institute investigations, to delay action pending investigation during which nothing of substance is being investigated, and, in the meantime, to permit public utilities to exact excessive payments from the public.²³⁷ In the next year, the Commission again stated that it would proceed to a determination of these matters "when investigations are completed." By the following year all promises to determine reasonable rates "when investigations are completed" were forgotten, and the Commission continued its misapplications of the sliding scale arrangement and of the statute. During these years, 1936 through 1942, the dividends were 60%, 65%, 65%, 65%, 59%, 59%, and 51.75%, respectively, while the earned surplus grew from \$26,987,031 at the end of 1935 to \$28,433,378 at the end of 1942.

In view of these facts, the conclusion is inescapable that there has been gross neglect in the application of the statute and of the sliding scale arrangement itself. This gross neglect, as I have indicated in my opinion last year,²³⁸ was not a one-sided matter. PEPCo. was definitely a party to it, and, since there is a close relationship both in the officers and directors of PEPCo., WRECo., and North American, it must also be concluded that these other corporations were also parties to the gross neglect in the application of the statute. In these circumstances, the earned surplus cannot be included in the property rate base on which the public must pay a fair return.

According to the Company's books, the earned surplus as of the end of 1943 was \$29,895,673.²³⁹ This, however, assumes that the capital stock invested in the operating property was \$8,000,000, whereas the amount actually received by the Company for its common stock did not exceed \$5,245,000, the remainder, \$2,755,000, having been charged to surplus. For a correct de-

²³⁷ See my dissent to Order No. 2712, relating to the fares of the Capital Transit Company, also a member of the same holding company system.

²³⁸ Order No. 2564, pp. 54-6.

²³⁹ Exh. 68, Sch. 2.

termination of the amount of earned surplus, this amount must be restored to surplus, making a total of approximately \$32,650,000. In this connection, it must also be observed that the book depreciation reserve as of the end of 1943 was approximately \$18,600,000.²⁴⁰ In regarding the property as having depreciated to the extent of approximately \$25,000,000, it was necessary to add some \$6,400,000 to the present depreciation reserve and to subtract this sum from earned surplus. Thus, the earned surplus would be adjusted to some \$26,250,000.²⁴¹

Obviously, if the original cost rate base of \$71,547,153 were reduced by the earned surplus in the amount of \$26,250,000, leaving only \$45,250,000, and a reasonable rate of return (as hereinafter determined) applied to the difference, the return to the Company would not be compensatory.

Even in a case of this character, the rule prevails that excessive rates in the past will not support confiscatory rates for the future, just as insufficient rates in the past will not support excessive rates for the future.²⁴² The facts of this case may warrant proceedings to recover the stock and past earnings from North American as trustee *ex maleficio*, but so far as the utility is concerned, it must be allowed a fair return. On the other hand, if the earned surplus is included in the rate base, there is conflict with the Congressional policy as set forth in Paragraph 75, and with the general rule that earned surplus, attended by irregularity, must be excluded from the rate base. This double-horned dilemma points to the conclusion that the cost or value of the Company's property, as the rate base for the purpose of fixing a fair and reasonable return, has been rendered inapplicable by past conduct. The rates should, therefore, be based not on the property of the Com-

²⁴⁰ Exh. 55.

²⁴¹ This is by no means the extent of the Company's excessive earnings during the life of the sliding scale arrangement, for during these years the Company distributed over \$45,000,000 as dividends on the common stock. If as much as 10% were considered a reasonable dividend, then the dividends on \$2,245,000 for 17½ years should have been only \$3,927,750, and the dividends on \$5,245,000 for 1½ years should have been \$786,750, or a total of \$4,714,500. In other words, the excessive earnings may be said to have been over \$40,000,000 in excess of the earned surplus.

²⁴² *Newton v. Consolidated Gas Company*, 258 U. S. 165, 175.

pany, but on the capital invested by its investors. "The thing devoted by the investor to the public use is not specific property, tangible and intangible, but capital embarked in the enterprise."²⁴³

In determining the amount of capital on which the Company is entitled to a fair return, it must be considered that it had issued bonds for which it received \$41,579,545; it issued preferred stock for which it received \$6,738,285, and it issued common stock for which it received at most \$5,245,000. All this money, so far as the record shows, has been prudently invested in the business. In addition, the Company has customers' deposits in the amount of \$1,501,091, which may also be considered as having been prudently invested in the business. These amounts, plus an allowance for working capital²⁴⁴ should constitute the rate base, as follows:

Bonds	\$41, 579, 545
Preferred Stock	6, 738, 285
Common Stock	5, 245, 000
Customers' Deposits	1, 501, 091
Working Capital	2, 562, 581
Prudent Investment Rate Base	57, 626, 492

It is on this amount that the Company may be said to be entitled to a fair return.²⁴⁵ However, lest these figures be given an unintended and unwarranted aspect of "accuracy," when, as a matter of fact, no rate base can be said to be accurate to the dollar, and there is little meaning in such seeming accuracy, and in order to make certain that the return will not fall below that to which the Company is entitled, the rate base may be given a round figure of \$58,000,000.

B. Revenues and expenses

Little has been said about the revenues and expenses of the Potomac Electric Power Company in this proceeding. The

²⁴³ *Mo. ex rel Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U. S. 276, 290.

²⁴⁴ It is debatable, whether in view of the facts of this case the Company is entitled to any allowance for working capital, if a capital rate base is to be used. All doubts are here resolved in favor of the Company in order to avoid "violent" changes in the rate structure.

²⁴⁵ As to the applicability of the sliding scale method to such a rate base, see Tr. pp. 2804-16.

revenues as reported by the Company have been taken for granted, and spot-check audits of expenses have been made, the main result being to adjust the operating expenses to their proper classifications in accordance with the Uniform System of Accounts. The adjustments were minor both in character and amount.²⁴⁶ The net result of the adjustments was to diminish the operating expenses, totalling \$10,614,734, by \$33,210. The questions pertaining to the reasonableness of the expenses were not raised or discussed. In view of the record, the expenses for the test year should be \$10,581,524.

Included in operating revenue deductions, however, there are two items which did involve considerable controversy. These are (1) depreciation, and (2) income taxes.

(1) *Depreciation*.—By the word depreciation, in this connection, is meant the annual accrual for depreciation during the test year, and is sometimes referred to as “depreciation expense.” From what has already been said, the straight-line method of computing depreciation offers the most reliable data for assuring to the utility a recoupment of the property as it is retired from service, and, where a property rate base is used, of assuring to the ratepayer that the rates will be based on the Company’s actual investment in property in its condition of depreciation, and not on any part of the investment which has already been recouped. The straight-line method is also more reliable, and has the further advantage in that it lends itself more easily to consistency as between its application to accrued depreciation and its application to depreciation expense. The requirement of consistency as between the two applications is of utmost value in the application of any method of depreciation. Following this method, the depreciation expense on the basis of 1943 should be \$2,600,809,²⁴⁷ plus \$8,096 as accrual for depreciation on emergency facilities which had not been included in the above figure.²⁴⁸ This makes a total of \$2,608,905 for depreciation expense for 1943 as the test year.

(2) *Taxes*.—Included in the operating revenue deductions

²⁴⁶ Tr. p. 251.

²⁴⁷ Exh. 34.

²⁴⁸ Tr. p. 1322.

for 1943 are various items of taxes aggregating \$4,086,551.88.²⁴⁹ These include Federal and District of Columbia income taxes and the District of Columbia gross receipts tax, which depend entirely upon the amount of revenue or income the Company received during the past year, and which are no indication of the amounts which will be paid by the Company during the next year, if the amount of revenue or income is substantially different. Exclusive of taxes which depend on the Company's income, the Company's taxes for 1943 totalled \$446,177,²⁵⁰ and these should be definitely treated as operating revenue deductions.

The computation of the taxes which depend on income should wait until the amount of revenue and income are determined. They are the District of Columbia income tax (\$229,237), the Federal electrical energy tax (\$443,945), the District of Columbia gross receipts tax (\$677,678), the Maryland income tax (\$6,270), the Maryland gross receipts tax (\$38,160), and, the most important of all, the Federal income tax (\$2,467,330). Since it is evident that the present return to the Company is excessive, and must be reduced, there is bound to be a diminution in all these taxes. The taxes, other than Federal income taxes, however, total \$1,395,290. With the reduction in income, these taxes will be reduced but not an amount which would make a substantial difference in rates. Therefore, for the purpose of determining the amount to which the Company may be entitled, all taxes, other than Federal income taxes paid in 1943, may be regarded as applicable for 1944, and the excess, like that resulting from the additional amount in the rate base, may be regarded as a safeguard that the Company will earn a fair return in 1944.²⁵¹ This is another doubt resolved in favor of the Company. Thus, taxes, totalling \$1,841,467, may be regarded as operating revenue deductions.

²⁴⁹ Exh. 12, Sch. 3, Sheet 5.

²⁵⁰ These include: Federal capital stock tax—\$85,000, D. C. real estate tax—\$157,216, D. C. license tax—\$10, Maryland personal property tax—\$8,768, county and township taxes—\$96,599, payroll taxes—\$90,584.

²⁵¹ On the basis of the reduction in gross revenue warranted by the facts of this case, the diminution in these taxes for 1944 may be as much as \$300,000.

The Federal income taxes require a different treatment. Of the \$2,467,320 of Federal income taxes paid in 1943, \$892,292 were excess-profits taxes, which will not have to be paid if there are no excess profits. Furthermore, with a net taxable income considerably less than \$4,690,584, the Company's excess-profits credit, the amount of normal tax and surtax will also be considerably less.

In the 1942 gas rate case ²⁵² this Commission disallowed excess-profits taxes and income taxes in an amount in excess of 31% of the net taxable income. The same rule was followed in the 1943 electric rate case. ²⁵³ In the 1943 gas rate case ²⁵⁴ excess-profits taxes were disallowed, but the full amount of both normal tax and surtax was allowed, because the Commission had reduced the basic rate of return from 6½% to 5¾%. In this case the Chief Accountant, following the rule laid down in the electric rate case of the preceding year, disallowed the excess-profits taxes in the sum of \$892,292. In applying 31% to the net taxable income, however, he computed the tax on a separate, rather than a consolidated, return ²⁵⁵ and gave no effect to the excess-profits tax credit, or to the deduction for dividends on preferred stock. ²⁵⁶ The result was that the 31% tax amounted to \$1,730,126, instead of 31/40 of \$1,575,028, or \$1,230,646. In other words, his 31% tax was \$155,098 greater than the actual 40% tax, and was \$499,400 more than had the excess-profits taxes been excluded and the income taxes allowed only to the extent of 31%, as compared with 40% of the net taxable income.

On the previous occasions I took the position that a utility is not entitled to allowance for excess-profits taxes, because it is not entitled to excess profits; ²⁵⁷ that income taxes should not be treated in the same category as operating expenses, because the tax is imposed upon profits after all service is rendered and paid for, and after all expenses are paid, and that, at any rate,

²⁵² 46 P. U. R. (N. S.) 1, 10-11.

²⁵³ Order No. 2564, pp. 20-3.

²⁵⁴ Order No. 2682, pp. 17-18.

²⁵⁵ Exh. 13.

²⁵⁶ Tr. pp. 262-265, 270-280, 300-316.

²⁵⁷ Comp. Tr. pp. 1851-2.

extraordinary income taxes, like war taxes, should not be passed on to the consumers. A different question is presented in determining what should be the return allowed in order to avoid confiscation. This was the problem presented in the *Galveston Case*,²⁵⁸ where the Supreme Court, in an opinion by Justice Brandeis, held that income taxes must be allowed as revenue deductions. If the amount allowed is the lowest reasonable return to which the Company is entitled, and no allowance is made for income taxes, then the resulting net return to the Company is apt to be confiscatory. To avoid this result, income taxes should be included to the extent to which it would be necessary to bring the net return up to the lowest reasonable amount. But disallowance of income taxes on earnings in excess of the lowest reasonable amount cannot result in confiscation, because the taxes constitute only a part of the additional income, not on more than 100% of it. The disallowance of any income taxes imposed upon the additional income still leaves the Company with a compensatory return greater than the lowest reasonable return.

The intervener argued that in computing reductions in rates the public should be given the benefit of the tax savings resulting from these reductions.²⁵⁹ Of course they should be. Otherwise, the reduction is a farce. For example, in Order No. 2564, the rates were said to have been reduced by \$310,000, because the Company's net operating revenue in the preceding year exceeded the basic return by some \$620,000. The actual reduction in net operating revenue, however, was only about \$60,000, assuming (contrary to fact) that there would be no increase in business. The so-called reduction of \$310,000 was, therefore, simply not so.

It has been suggested in opposition that if such a procedure were followed, the same rule would apply to increases in rates. It should, but only to the extent necessary to avoid confiscation. It would be absurd to apply the same rule to any increases in excess of the lowest reasonable return. An apt example of this absurdity is that if, as the Company's witness

²⁵⁸ *Galveston Electric Co. v. Galveston*, 258 U. S. 388, and see especially p. 400, n. 8.

²⁵⁹ Tr. pp. 1824, 1837-49, 1937, 2650-60, 2673.

testified, the return on a fair value base is \$2,000,000 short of what it ought to be, then giving effect to the increase in taxes would mean that the rates should be increased by \$10,000,000.²⁶⁰ It can hardly be said, however, that anything less than this increase would result in confiscation. If the Company were in such dire circumstances, it would not have been in the excess profits tax bracket. Its deductions from gross income, to compute the net taxable income, would probably have been so great that it would have had to pay no income tax at all. In such circumstances, if its net operating income must be increased by \$2,000,000 in order to avoid confiscation, such an increase would probably have resulted in a very small increase in income taxes. It has also been suggested that to give the consumers the benefit of tax savings resulting from reductions in the net return would mean to deprive the United States of revenue.²⁶¹ This argument must be rejected as not being made in good faith.²⁶² Suffice it to say that Congress has not designated PEPCo. as a Collector of Internal Revenue, nor has it embarked upon a policy that a public utility corporation should maintain high charges so that it might pay high taxes.

All this points to the conclusion that the problem of income taxes as operating revenue deductions cannot be solved by giving effect to the taxes paid in 1943, or by giving effect to a so-called adjustment to 31% of the net taxable income for 1943, or by the application of a formula which is based on assumptions contrary to fact. It can be solved only by first determining what should be the lowest reasonable return and then by

²⁶⁰ This is indeed an underestimate. If the net income is to be increased by \$2,000,000 the gross revenue would have to be increased by about \$14,000,000.

²⁶¹ PEPCo. brief, pp. 12-14. See, also Order No. 2564, pp. 88-90. On June 19, 1944, the Treasury Department issued a press release to the effect that "contrary to an impression created by recent press articles, the Treasury Department has no intention of opposing, because of possible adverse effects on Federal revenues, reductions in rates charged by public utility companies."

²⁶² Of the same character is the argument that a reduction in rates would have an inflationary effect, contrary to national policy. The contrary is true, as may be gathered from Executive Order No. 9328, issued April 8, 1943. At any rate, in the absence of the Congressional policy, that public utility corporations should grow fat, so that the great masses of people might not enjoy a high standard of living, the argument must be rejected.

computing the amounts of taxes dependent upon such a return. As will be seen presently, only \$173,880 will be the amount of Federal income taxes which the Company will have to pay for 1944, if the return is reduced to what may be considered as reasonable.

The deductions from gross revenue to which the Company is entitled may, therefore, be summarized as follows:

Operating expenses.....	\$10, 581, 524
Depreciation	2, 608, 905
Taxes, other than Federal income taxes...	1, 841, 467
Federal income taxes.....	173, 880
	\$15, 205, 776

The sum of \$15,206,000 is the amount which the Company must receive as gross revenue, in addition to a "fair return" on the capital investment.

C. Fair return

In rate regulation, the pervading purpose is to arrive at rates which would yield a "fair return" to the utility, assuming, of course, that the units of service rendered are otherwise worth the rates or charges so established. The concept of "fair return," however, is itself not a simple one. It is the product of two factors, the rate base and the rate of return. The return is the same, if the rate base is diminished and the rate of return proportionately increased, or if the rate base is increased and the rate of return proportionately diminished.

In cases or controversies relating to rates, the alleged legal damage relates to the return allowed, not to either of the two factors which enter into the computation. When a utility claims that the rates established are too low, it in effect asserts that the return is insufficient; likewise, when the consumer claims that the rates are too high, he in effect claims that the return derived from the consumers as a whole is excessive. This is the reason why in the judicial review of rate decisions, the courts look to the justice or reasonableness of the consequences," ²⁶³ rather than to the rate base or to the rate of return,

²⁶³ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U. S. 591, 88 L. Ed. 276, 283.

except to the extent that these factors constitute evidence of the result.

Rate cases are complicated by the fact that, generally, both the rate base and the rate of return are under attack. Rarely is the correctness of the rate base admitted, and the controversy centered about the rate of return; rarely is the correctness of the rate of return admitted, and the controversy centered about the rate base. At times, the cases are further complicated by an alleged relationship between the rate of return and operating expenses or other revenue deductions, like depreciation ²⁶⁴ and taxes. If there is a strict application of the rule that in computing the net operating revenue only such expenses are deductible from gross revenue as are incurred in rendering service to the public, are reasonable and meet the requirements of prescribed accounting, then the resulting return, hence also the rate of return, will be greater than if these tests were so applied as to yield largely to managerial judgment.

Evidently, if there is any meaning in the term "fair rate of return," it cannot be a function either of the rate base, or of the operating expenses or other revenue deductions; otherwise, in the determination of the proper return, one of necessity finds himself in the midst of a vicious circle. The rate base must be determined upon principles independent of those underlying the determination of the rate of return; likewise, the determination of the allowable expenses and the other income deductions must be based on principles independent of those underlying the determination of the rate of return.²⁶⁵ When it comes to determining the proper rate of return, the rate base must be regarded as fixed and determined. With this postulate, it is proper to define a "fair rate of return" as that ratio which, when applied to the rate base, will produce a fair return to the utility.

The evidence on the rate of return in this case related mainly to what has been called the "cost of capital." The idea stems

²⁶⁴ Tr. p. 1497, Exh. 52, Tables IIIa, IIIb, and IIIc. See, also, Order No. 2682, pp. 25-6.

²⁶⁵ But Comp. Tr. pp. 929-932.

from the prudent investment theory developed by Justice Brandeis,²⁶⁶ but the idea was not applied by the witnesses in accordance with his theory. For an appraisal of their evidence, therefore, it is important first to review the basic elements of the theory on which "cost of capital" as the fair rate of return is founded, and then the application of the theory to this case.

(1) *Basic elements of the prudent investment theory.*—Justice Brandeis promulgated the theory that a public utility corporation is an arm of the State, organized for the purpose of rendering a public service, rather than for the purpose of making profits. This entity, as distinguished from the persons who invest their funds in it, must render service at "cost." The term "cost," however, means more than cost of operation. It also includes cost of capital. The corporation incurs expenses in obtaining loans and must pay interest to its bondholders; both the expenses and interest are part of the "costs" incurred by the corporation in rendering service. The same holds true about money it obtains and for which it issues preferred or common stock; the expenses incurred and dividends paid are part of the "costs" of rendering service to the public.

This being so, the costs incurred in the nature of capital charges must follow substantially the same rules as are applicable to other costs incurred. The costs must be reasonable, and whatever economies are effected must inure to the benefit of the public. If the cost of bond money is 3%, and the cost of preferred stock money is 4%, these amounts, and no more, may be properly charged to the public. The cost of common stock money, likewise, is limited by the rule of reasonableness,²⁶⁷ and no more than reasonable amounts may be properly charged to the public.

Two important corollaries flow from this principle: (a) that the financing of the utility must have been proper, and (b) that the cost of conducting the business, including capital costs, are applicable only to a prudent investment rate base.

²⁶⁶ *Missouri ex rel. Southwestern Bell Telephone Co. v. Public Service Commission*, 262 U. S. 276, 289 et seq.

²⁶⁷ See note No. 212, *supra*.

(a) In defining a fair rate of return to which a utility is entitled, Justice Brandeis said (p. 306):

Where the financing has been proper the cost to the utility of the capital required to construct, equip, and operate its plant should measure the rate of return which the Constitution guarantees opportunity to earn.

For financing to be "proper," it must appear that the securities issued are equivalent to the cash received by the corporation. If securities having a face value of \$1,000 are issued for \$500, the latter, rather than the former, amount represents the capital investment. If securities are issued for property the cash equivalent of the property measures the investment. If securities are issued in exchange for other securities, which in turn are represented by property, the cash equivalent of that property measures the investment of the securities issued in the exchange. If securities are issued for "services rendered," when no services in fact were rendered, there is no investment representing such securities. The investment does not grow through mere transactions in securities nor through bookkeeping entries. It grows only through the receipt of money or the equivalent thereof by the corporation.

With the amount of investment of the various types of securities, sometimes called "sources of capital" ascertained, the next step is to find the cost of the money to the utility. In the case of securities carrying a fixed obligation, like bonds or preferred stock, the ascertainment of the cost of the money received by the corporation is comparatively simple. In the case of securities like common stock, which do not carry a fixed obligation, the cost to the utility is the reasonable amount to be paid for the use of funds so invested. When all of these costs are ascertained the weighted average cost of the various sources of capital constitutes the rate of return.

(b) This rate of return, according to Justice Brandeis, should be applied to a prudent investment rate base. He said (p. 306):

The adoption of the amount prudently invested as the rate base and the amount of the capital charge as the measure of the rate of return would give definiteness to these two factors in rate controversies which are now

shifting and treacherous, and which render the proceedings peculiarly burdensome and largely futile. Such measures offer a basis for decision which is certain and stable.

What did Justice Brandeis mean by "the amount prudently invested?" He had specific reference to the theory followed by the Massachusetts Commission,²⁶⁸ namely, that:

Capital honestly and prudently invested must, under normal conditions, be taken as the controlling factor in fixing the basis for computing fair and reasonable rates; that if there is mismanagement causing loss, such loss must be charged against the stockholders legally responsible for the mismanagement.

On the other hand, no unearned increment can be a determining basis for computing rates. Earned surplus is likewise not part of the prudent investment rate base, for that is not invested by either the stockholders or creditors. As the Massachusetts Commission said:²⁶⁹

Additions and betterments paid for out of earnings offset depreciation and protect investment, but form no part of it.

In other words, so long as the financing was proper and the money obtained through the financing was honestly and prudently invested in plant, the total of the invested capital is the rate base.²⁷⁰

²⁶⁸ Bay State Rate Case, P. U. R. 1916 F. 221, 233.

²⁶⁹ Ibid p. 258.

²⁷⁰ In commenting on "prudent investment," Justice Reed, in his dissenting opinion in *Federal Power Commission v. Hope Natural Gas Company*, 320 U. S. 591, 88 L. Ed. 276, 294, said:

"It may mean the sums originally put in the enterprise, either with or without additional amounts from excess earnings reinvested in the business."

It may be argued that, in accordance with Justice Brandeis' opinion, earned surplus should be included in the rate base, for he said (p. 307):

"It (the rate base) would, when once made in respect of any utility, be fixed for all time, subject only to increases to represent additions to plant after allowance for depreciation included in the annual operating charges." He meant, however, only such increases in plant as represent additional

(2) *Application of the prudent investment theory in this case.*—Now it is interesting to see what evidence was introduced, supposedly in application of this theory, and what is the proper application of the theory. Here, also, we should discuss (a) the cost of capital and (b) its application to the rate base.

(a) *Cost of capital.*—There is no dispute as to the proper computation of the cost of the Company's bond money. The Commission's Chief Accountant showed that for the \$40,000,000 of bonds issued, the Company actually received \$41,579,545; that the interest and expenses representing the cost of this money is \$1,250,592; and that the average cost of the money actually received was therefore 3.008% per year.²⁷¹ He compared this cost with the cost of other AAA or AA bonds recently issued by other utilities.²⁷² It appears that the cost of the bond money is relatively high, compared with these other bond issues, but not unreasonably so. Therefore, 3.008% must be regarded as the proper cost of bond money to the utility, for which cost it should be annually reimbursed by the consumers.

There is also no dispute as to the proper computation of the cost of the preferred stock money. The Chief Accountant showed that, in issuing \$7,000,000 of preferred stock, the Company actually received a net of \$6,738,285. The Company must pay annual dividends in the sum of \$395,000, and, therefore, the cost of this capital is 5.862%. A comparison of this cost with the recent issues of preferred stock, however, shows that 5.862% is unreasonably high.²⁷³ As an alternative, the Chief Accountant suggested that the Company be allowed only

securities issued, for, in commenting on what the common stockholder may expect by way of return on his investment, he said (p. 307, n. 19):

"If he (the investor) elects to invest in the stock, he would, under the rule suggested, have the opportunity of earning a rate *commensurate with the value of the capital at the time it was embarked as stock in the enterprise.*" [Italics supplied.]

By "increases to represent additions to plant" he might have meant to include such surplus as could result from reasonable rates after the payment of reasonable dividends, but such surplus would not be sufficiently large to affect the return to any greater extent than is necessary to safeguard the capital invested.

²⁷¹ Exh. 26, Sch. 2.

²⁷² Exh. 23.

²⁷³ See Exh. 24.

5%.²⁷⁴ This would mean to allow the Company some \$60,000 less than the actual cost of preferred stock capital. I think that the Company should be directed to refinance its preferred stock at more advantageous terms; until it has been so instructed and it has failed to comply, it is entitled to a return which would include 5.862% of its preferred stock capital, since that is one of its fixed charges.

When it came to computing the amount of common stock capital and the cost thereof, however, both the Commission's witness and the Company's witness departed entirely from the "cost of capital theory."²⁷⁵ Instead of regarding the amounts actually received by PEPCo. for its common stock as the source of capital, they substituted the "common stock equity"²⁷⁶ of \$37,440,115,²⁷⁷ or \$37,895,673.²⁷⁸ Yet, these are not the amounts either paid by the investor, or received by the Company, for the common stock. That amount is at most \$5,245,000.²⁷⁹

The inclusion of the difference between the "common stock equity" and the maximum of \$5,245,000 is based on fictions which are contrary to law and fact. For example, the com-

²⁷⁴ Exh. 26, Sch. 4.

²⁷⁵ Tr. pp. 942-3.

²⁷⁶ The term "common stock equity" is used to represent the sum of the stated common stock capital and the earned surplus. The word "equity" gives the impression of something right or correct. It is, however, a term borrowed from the law applicable to conditions which bear no relation to the facts we are now dealing with; its analogy is the "equity of redemption." In cases of foreclosure, involuntary reorganization or dissolution, the bondholders must be paid first, then the unsecured creditors, then the preferred stockholders, and what is left goes to the common stockholders. This is how a court of equity would dispose of the property. A foreclosure, involuntary reorganization or dissolution, however, follows financial difficulties, and the amount left to common stockholders is little or nothing. On the other hand, if the earned surplus is high, and the business prospers, there is no occasion for foreclosure, involuntary reorganization or dissolution, and no occasion for the use of the term "equity."

²⁷⁷ Exh. 26, Sch. 4.

²⁷⁸ Exh. 63, Sch. 6. This figure, like the one in Exh. 26, Sch. 4, was arrived at by eliminating \$1,000,000 of the common stock issued by the Company for an interest in the Great Falls power site as being devoted to nonoperating property. Query: If the earned surplus attaches to the common stock, should not a proportionate part of the earned surplus likewise be eliminated

²⁷⁹ Tr. p. 937.

mon stock stock equity is said to "belong" to the common stockholders,²⁸⁰ which is definitely wrong, because the property belongs to the corporation, not to the stockholders. Then it is said that this is so because the corporation "belongs" to the stockholders. But this is only an attempt to obscure facts through phraseology. The common stock equity belongs to the corporation in the sense that the property so represented is owned by the corporation; the corporation belongs to the stockholders only in the sense that the latter own choses in action which give the stockholders certain rights, among which is to elect directors who, in turn, appoint officers, who, in turn, manage the affairs of the corporation.

It is then said that the difference between the common stock equity and the actual investment in the common stock is the money which the stockholders had "plowed back into the business."²⁸¹ Obviously, this is a metaphorical expression. It means, the President of PEPCo. testified, that the surplus must be considered as if the earnings had been distributed in their entirety and new stock had been sold to the same stockholder for the same amount of money. As has already been pointed out, however, this assumes a set of facts which have no basis in sound business management. The real assumption behind this "plowing" business is that the difference must be treated as if the earnings had been distributed as stock dividends. But then the assumption is contrary to Paragraph 75 of the statute.

To the amount of common stock equity, rather than the actual investment in common stock, the Chief Accountant assigned an annual return of 7.50% to be borne by the consumer.

The processes behind the method²⁸² of arriving at such annual return on common stock money are most remarkable, and in the interest of clear thinking should be analyzed. *First*, it is *observed* that a common stockholder is interested in dividends, and that he is also interested that the company's earn-

²⁸⁰ Tr. pp. 37-40, 713, 778, 857-8.

²⁸¹ Tr. p. 706, 780.

²⁸² The Chief Accountant explained that he followed the method largely discussed in a rate of return study based on cost of capital, made for the Federal Communications Commission by members of its staff. Tr. pp. 896-7.

ings be higher than the dividends. *Second*, it is *observed* that the prices paid by investors for common stock vary from day to day. At times the variations are small, at times great; at times they are influenced by factors relating to the corporation in whose stock he invests, at times by other factors, like a political election, or a declaration of war, or invasion, etc.²⁸³ *Third*, it is *assumed* that the investor sits back in his easy chair, reviews all the factors, past, present, and future, which influences his willingness to invest, and, never disclosing his data, decides upon the price he is willing to pay for stock, depending always on the amounts the company would earn, and he would receive, on each share of stock. The dividend-price ratio and the earnings-price ratio are thus assumed to constitute his "appraisal" of the stock. *Fourth*, then comes a statistician, somewhat deficient in his knowledge of mathematics, especially in the probability of error, averages the dividends, earnings, and prices, over a period of a year, and arrives at the average dividend-price ratio and earnings-price ratio for each corporation. This average is carried out to the second or third decimal place, so that it has the appearance of great accuracy, but the margin of error is never disclosed. *Fifth*, then this process is repeated and average earnings-price ratios are arrived at for several years and for a number of companies of similar characteristics (without necessarily disclosing the points or extent of similarity). Not being content with that, the statistician arrives at composite averages, and at composite weighted averages, where the weighting factors are spun out of thin air. The result is a dividend-price ratio and an earnings-price ratio, which are said to constitute the investor's appraisal of stock, where the "investor" is a hypothetical being like Adam Smith's "economic man."²⁸⁴

It is upon such data that the Chief Accountant presented his composite weighted average dividend-price and earnings-price ratios for 14 electric operating utilities for the years 1939 through 1943.²⁸⁵ The dividend-price ratio is 6.89%, while the earnings-price ratio is 7.82%. The Company's witness on this

²⁸³ Tr. pp. 1062-5.

²⁸⁴ Tr. p. 898.

²⁸⁵ Exh. 25.

subject thought that the dividend-price ratio was a measure of the investor's appraisal of common stock, but that the earnings-price ratio was neither the investor's appraisal of the stock nor a proper measure of the earnings to be allowed, unless many adjustments were made. He pointed out that the earnings-price ratios depended entirely on the periods selected, and whether consideration was given to the annual high and low prices, the volume of trading, the percentage of common stock equity in the capital structure of the Company, and other matters. By subjecting the Chief Accountant's data to somewhat different arithmetical treatment, he raised the composite weighted average earnings-price ratio of 7.50% to 8.04%;²⁸⁶ by considering "indicated market values," he raised the ratio to 8.27%;²⁸⁷ by making computations on the basis of volume of trading, he raised the ratio to 8.82%;²⁸⁸ and by applying a "capitalization factor; he raised the ratio to 9.463%.²⁸⁹ The witness admitted, however, that he could not tell what consideration should be given to each of these factors and what adjustments should be made without an "extensive study." Obviously, the difficulty lies deeper than the mere need for an extensive study in order to arrive at a correct result. The difficulty lies in the fact that with all the extensive studies made, the results obtained would still fail to lend meaning to the term "investor appraisal" as the relationship between corporate earnings and the prices paid for stock.

Having shown that the composite average dividend-price ratio is 6.89%, the Chief Accountant reasoned that PEPCo. should be in a position to declare such dividends on its common stock, and that it should earn a percentage comparable to the composite weighted average earnings-price ratio of 7.82%. However, since PEPCo. is in a better condition of financial stability than the companies selected for comparison, and the risk in this investment is not as great, he considered that 7.50% was a sufficient earnings-price ratio for this stock.

The 7.50%, however, was applied not to the market price

²⁸⁶ Exh. 63, Sch. 1.

²⁸⁷ Exh. 63, Sch. 1.

²⁸⁸ Exh. 63, Sch. 2.

²⁸⁹ Exh. 66.

of PEPCo. common stock, but to its common stock equity! This can be right only if the market price of stock is equal to its common stock equity. Again we are plunged into assumptions which have no basis in reality. It is assumed that if PEPCo. common stock were traded on the market the shares would sell at their common stock equity. But the common stock of PEPCo. is not on the market. It has been, from almost its very beginning to the present time, owned by WRECo. The latter's common stock has so grown in value that it has become unmarketable. This stock is owned by the North American Company. Several attempts have been made to break up the WRECo. common stock into small units so as to render it marketable. These attempts failed. The present plan is to transfer a great part of PEPCo.'s earned surplus and to issue new stock with a par value of \$10 so that PEPCo.'s stock would be marketable. But the plan comes in direct conflict with the provisions of law. Therefore, there is no basis for the assumption that PEPCo. common stock could be marketed; there certainly is no basis for the assumption that the stock would sell at its equity value.²⁹⁰

Evidently, the assumptions underlying the application of 7½% to common stock equity are without foundation. The Chief Accountant's 7½%, as applied, is not an earnings-price ratio at all, but an earnings-equity capital ratio. If this is to be the measure of earnings to be allowed on PEPCo.'s common stock, and, if comparisons are to be made, then they must be based on similar ratios applicable to other companies having similar characteristics. For another purpose, the Chief Accountant had selected ten companies, all of which had been subjected to a reclassification under the Uniform System of Accounts.²⁹¹ Their average earnings-equity capital ratio for 1942 was 6.42%. Considering the PEPCo. is in a better condition of financial stability, the ratio to be applied to a common

²⁹⁰ The common stock equity is approximately \$39,000,000 (Exh. 63, Sch. 6). This, divided by 90,000 shares, is \$433 per share. If the \$1,000,000 representing an interest in the Great Falls power site were eliminated, then the common stock equity of \$38,000,000, divided by 80,000 shares, would mean \$475 per share. See Tr. pp. 901, 936.

²⁹¹ Exh. 3, Sch. 4.

stock equity should be 6%, rather than 7½%, provided, of course, that "common stock equity" is a proper source of capital on which costs must be paid by the consumers. Then the average "cost of capital" should be 4.5%, not 5.17% found by the Chief Accountant.

The Company's witness arrived at the conclusion that the earnings-equity capital ratio should be 10.04%. He arrived at this figure by a comparison of PEPCo. with eight electric operating utilities whose only points of similarity with PEPCo. were that their common stock equity bore substantially the same relation to their entire capital structures as the common stock equity of PEPCo. bore to its capital structure, and that their bonds were rated AAA.²⁹² An important difference, however, is that six out of the eight companies have not had their accounts reclassified under the Uniform System of Accounts, and this has a direct bearing on the earnings-equity capital ratios.

The upshot of all these computations is that according to the Chief Accountant the Company should be allowed \$2,808,000 on its common stock capital,²⁹³ while according to the Company's witness the amount should be at least \$3,797,146, but more likely \$3,990,414.²⁹⁴

It is strange how difficult an answer can be made to a rather simple question; how many tables and computations are required to obscure the issue; and how, by the use of words and phrases with varying shades of meaning the entire issue can be plunged into confusion.²⁹⁵ Perhaps a statement of the question in simple language will also yield a simple answer. As has already been indicated, if dividends on common stock were a fixed obligation, the question would be: How much must PEPCo. pay for the money it got for its common stock? The answer would appear immediately from the Company's books and records. Since the dividends are not a fixed obligation, the question is: How much should the Company pay for the

²⁹² Exh. 67, Sch. 1.

²⁹³ Exh. 28, Sch. 4.

²⁹⁴ Exh. 62, Sch. 2.

²⁹⁵ Comp. Tr. pp. 1853-4.

\$5,245,000 it got for its common stock, and, therefore, how much should the consumers pay to reimburse the Company for such cost? The answer need not be obscured by numerous computations. Without elaborate tables, it can be determined how much should be paid on money invested in a company of this character. Six percent would be quite a liberal dividend. If not, 7% or 7½% would surely be. Since it is recognized that the Company should have some additional earnings to be added to surplus, in order to safeguard common stock dividends in the future, 10% would surely be an ample allowance. The 6%, 7%, 7½%, or the 10%, however, must be applied to the money actually received by the Company from its common stockholders. Ten percent on \$5,245,000 would be \$524,500, not \$2,800,000, nor \$3,990,000. The cost of common stock money should not be computed on anything above \$5,245,000, because that money never cost the Company anything; ²⁹⁶ it had not been contributed either by the investors or creditors, but by the ratepayers. By no stretch of the imagination can it be said that there is either a legal or moral obligation on the part of the ratepayers to pay for that money which was actually paid by them in the form of rates. The fact that in the years past, throughout the sliding scale arrangement, the Company earned between \$2,500,000 and \$4,500,000 per year over and above all its expenses, depreciation, taxes, interest, and preferred stock dividends, shows that the ratepayers had paid too much; it has no bearing whatever on the cost which the Company should pay for the use of the money it received for its common stock.

It is at this point that the relevancy and materiality of Exhibit 74 may be fully appreciated. If the reorganization plan now in contemplation is carried into effect, and the investment in common stock (\$5,245,000) is turned, through stock dividends, into an investment of \$31,500,000, and if 10% were allowed as earnings on the common stock, then the consumers would have to contribute \$3,150,000, rather than \$524,500 to-

²⁹⁶ Tr. p. 937.

ward the support of this part of the capital structure. This is the amount now claimed by the Company.²⁹⁷

The Chief Accountant also included customers' deposits, in the sum of \$1,501,091, as a "source of capital" on which the Company must pay interest, in the sum of \$58,038, on the basis of experience for 1943. There is no doubt that this amount should be allowed as a capital cost. The inclusion of the deposits in the sources of capital, however, suggests that this money might have been invested in plant, and should be deducted from the rate base as being a customers' contribution, if the rates are based on the amount of property in the plant. If, however, the rate base is the amount of *capital* honestly and prudently invested in plant, it makes no difference whether the customers' deposits are included in the capital invested, and the interest paid is included as one of the costs of capital; or the customers' deposits are excluded from the capital invested, and the Company is allowed the interest paid as an operating expense.

After arriving at the rates and amounts which should constitute the cost of the various types of capital, the Chief Accountant arrived at a weighted average rate of 5.171%.²⁹⁸ The Company arrived at average rates ranging between approximately 6.3% and 6.5%.²⁹⁹ If the actual costs are allowed for long-term debt, preferred stock and customers' deposits, and 10% is allowed on the common stock money actually received by the Company, then the average cost of capital is 4%.³⁰⁰ This, according to the cost of capital theory, is the rate of return which, as Justice Brandeis said, "the Constitution guar-

²⁹⁷ This is approximately the amount claimed by the Company (Exh. 63, Sch. 6), somewhat more than provided for in the Chief Accountant's Exhibit 26, Sch. 4. This is another illustration that their computations constitute a circumvention of Paragraph 75.

²⁹⁸ Exh. 26, Sch. 4.

²⁹⁹ Exh. 68, Sch. 2.

³⁰⁰ Computed as follows:

Bonds -----	\$41, 579, 545 @ 3. 008%	\$1, 250, 712
Preferred stock -----	6, 738, 285 @ 5. 862%	395, 000
Common stock -----	5, 245, 000 @ 10%	524, 500
Deposits -----	1, 501, 091	58, 038
	55, 063, 921 @ 4. 06%	2, 228, 250

antees opportunity to earn." This is the rate which the consumers are obliged to pay and which the Company is entitled to receive.

(b) *Application to rate base.*—The Commission's staff presented various figures which might be adopted as the rate base, but made no recommendation which of the figures should be adopted.³⁰¹ Since the Chief Accountant arrived at a rate of return of 5.171%, because \$4,511,759 was the cost of capital totaling \$87,259,037, he already arrived at the rate base corresponding to his rate of return, unless this figure included nonoperating property, in which case the rate of return should be applied only to that part of the invested capital which is represented by operating property. He had, however, excluded the investment in the Great Falls Power site. Therefore, his rate base should have been \$87,259,037, less any other nonoperating property which the Company might have.

In applying the rate of return, however, he did not regard the invested capital as the necessary rate base. According to his approach, the same rate of return could be applied to the sliding scale rate base or to the original cost rate base. For a different purpose, he made tabular comparisons³⁰² of the results flowing from the present sliding scale arrangement and those flowing from the application of a rate of return of 5¼% or 5% to the sliding scale rate base and to the original cost rate base. His tabulations yield the following figures as to net operating revenue (the return) and the corresponding reductions in gross and in net revenue.

Example	Net operating revenue	Reduction in gross revenue	Reduction in net revenue
Present Sliding Scale Arrangement 1943.....	\$5, 349, 796	-----	-----
A. Sliding Scale less Reduction of \$390,574 from Gross Revenue (Exh. 12).....	5, 275, 587	\$390, 574	\$74, 209
B. Sliding Scale Rate Base Depreciated at 5¼%.....	4, 823, 217	901, 135	175, 582
C. Sliding Scale Rate Base Depreciated at 5%.....	4, 715, 268	1, 081, 050	283, 531
D. Original Cost Rate Base Depreciated at 5¼%.....	4, 675, 161	1, 147, 896	323, 639
E. Original Cost Rate Base Depreciated at 5%.....	4, 574, 262	1, 316, 060	424, 537
F. Original Cost Rate Base Depreciated at 5% according to Exh. 45.....	4, 145, 581	2, 030, 530	853, 219

³⁰¹ Tr. p. 819.

³⁰² Exh. 73, the purpose of which was to show the effect of various rate reductions on earnings and coverage ratios.

The comparative figures condemn the sliding scale arrangement.³⁰³ One need only ask: Why should the rates for 1944 be based on a return of \$5,275,587 (Example A) to the Company, when a return of 5% on the original cost rate base would yield a return of only \$4,145,581 (Example F)? In other words, why should the consumers be required to pay as much as approximately \$1,640,000 (\$2,030,530 less \$390,574) just because a "formula" governs the rate determinations? However, these two figures are hardly comparable. *First*, because the net operating revenue in Example A is computed with an allowance of \$2,479,574 for depreciation, whereas in all other examples the allowance for depreciation is \$2,830,570.³⁰⁴ In other words, the difference of \$1,640,000 should be increased by \$350,000 plus taxes thereon at the rate of at least 40% or by \$583,000, thus making a difference of some \$2,223,000. *Second*, because the net operating income under the sliding scale arrangement for 1943 was not \$5,349,796, as represented in this tabulation, but \$5,890,129. Therefore, the difference of \$2,223,000 should be further increased by approximately \$540,000 (\$5,890,129 less \$5,349,796) plus taxes thereon or by \$900,000. In other words, on this basis, the cost of the sliding scale arrangement to the consumers is over \$3,000,000 per year. *Third*, because while Example A is said to be based on the present sliding scale arrangement with a 6% rate of return and an undepreciated sliding scale rate base, these are not the assumptions relating to Example B through F. Furthermore, what the Chief Accountant did in Examples B through E was not to arrive at the net operating income by merely applying the rate of return to the rate base, but also by adding one-half of the 1943 income in excess of such a return and making allowances for additional taxes to be paid on this one-half of the excess.

Bearing the latter point in mind, one can appreciate the differences between Examples C, E, and F, in all of which the rate

³⁰³ The reason set forth is by no means intended to exclude the reasons assigned in the intervenor's briefs. (Treasury brief, pp. 25-6, 33-5, 96-7; F. W. A. brief, pp. 14-59.)

³⁰⁴ It includes amortization for emergency facilities. See Tr. p. 346, where it is admitted that these facilities may last as long as 10 or 20 years.

of return is the same (5%). Example C contains two elements of the sliding scale arrangement—the rate base and one-half of the excess earnings. Example E contains only the second of these two elements. Example F does not contain either element. In this view, it appears the two elements taken together would cost the public about \$950,000 (\$2,030,530 less \$1,081,050) per year, while the element of excess earnings would cost the public about \$725,000 (\$2,030,530 less \$1,316,060) per year, if the computations were otherwise correct. But the computations are not correct. The net operating income in Examples C and E are affected by the assumption that for 1943 such income was only \$5,349,796, which, as has been stated, was some \$540,000 short. In addition, in the computation of the “depreciated rate base” the Chief Accountant used the book reserve of \$17,896,912, whereas in Example C he should have used the sliding scale depreciation reserve of some \$17,000,000.³⁰⁵ Furthermore, for Examples E and F a more proper depreciation figure would be some \$25,000,000.³⁰⁶

It would serve no useful purpose to make a detailed comparison between the return under the sliding scale arrangement and each of the assumptions made, after adjusting all elements. It is sufficient to compare the return under the sliding scale arrangement with a 5% rate of return applied to the original cost rate base depreciated. As has been stated, such a rate base, including working capital, is \$74,109,734. A 5% return on this item is \$3,705,000, which must be earned over and above operating expenses, depreciation, and taxes. The expenses (\$10,581,524), depreciation (\$2,608,905), taxes, other than Federal income tax (\$1,841,647), the Federal income tax (\$727,713),³⁰⁷ and the return (\$3,705,000) would total \$19,464,789. The reduction from the 1943 gross revenue of \$22,530,657 should, therefore, be over \$3,000,000, not \$1,316,060.

A rate base reflecting the amount of property in the plant, however, is not applicable to this case, because no return should

³⁰⁵ Sliding scale depreciation reserve as of December 31, 1942—\$16,127,563; as of December 31, 1943—\$17,824,723; the mean figure is \$16,976,145.

³⁰⁶ Reserve requirement as of December 31, 1942—\$23,903,571 (Exh. 31), plus net increase for 1943—\$1,114,912 (Exh. 45).

³⁰⁷ For the method of computation, see note No. 308.

be allowed on the earned surplus, and, if the depreciated rate base is diminished by the earned surplus, then the resulting return would be noncompensatory. The rate of return of 4% should, therefore, be applied to the prudent investment rate base of \$58,000,000. This would mean that over and above all expenses, depreciation, and taxes, including Federal income taxes in the sum of \$173,880,³⁰⁸ the Company is constitutionally entitled to a return of \$2,320,000. On this basis, the gross revenue for 1944 should be \$17,526,000, and the reduction in rates should be at least \$5,000,000.

The Company takes a different view. While it introduced evidence to show that without the sliding scale arrangement it would be entitled to a 6% return on a rate base of over \$139,000,000 with a depreciation of \$22,000,000, it was not seeking a rate increase. It also thought that there should be no rate reduction.³⁰⁹ It was satisfied with the present return. It argued that it must have a return of some \$5,500,000,³¹⁰ in order

³⁰⁸ If the net return, after expenses, depreciation, and taxes, including D. C. income taxes, is \$2,320,000, the amount of Federal income taxes can easily be approximated. To this amount should be added the depreciation allowed, and there should be deducted the depreciation at 3.2% allowed for income-tax purposes and interest on long-term debt. There are still other deductions, but they are not significant. Thus:

Net return allowed	\$2, 320, 000
Add back depreciation allowed	2, 608, 905
Income subject to tax	4, 928, 905
Deductions:	
Depreciation (3.2% of \$96,421,615, depreciable property as of December 31, 1942)	\$3, 085, 490
Interest on long-term debt	1, 250, 712
	4, 336, 202
Subject to normal tax (24%)	592, 703
Preferred stock dividends	395, 000
Subject to surtax (16%)	197, 703
Normal tax	142, 248
Surtax	31, 632
Total income tax	173, 880

³⁰⁹ PEPCo. brief, pp. 11-14.

³¹⁰ Exh. 68, Sch. 2.

to attract capital. The Company's witnesses stated that in the next 10 years it will have to raise \$38,000,000 of new capital, and there are certain requirements for the highest or AAA rating of bonds. The two requisites relied on by the Company's witnesses were: (1) that the net income must be at least 19% of the gross revenue, and (2) that the gross income must be at least 12% of the long-term debt. In other words, \$4,800,000 is the minimum, and the present return is sufficient.

An examination of the source of the Company's evidence as to the requisites for AAA rating of bonds (Proceedings of the Conferences on Bond Portfolios, 1939, p. 85)³¹¹ discloses that the above requisites are the fifth and seventh of the seven tests set forth in their order of importance, as follows:

(i) Fixed charges coverage— $2\frac{3}{4}$ times or more. This means that to meet this test, the return, plus nonoperating income, must be at least \$3,278,000. This test would be met by an original cost rate base of \$74,000,000 and a rate of return of 5%, but not by a prudent investment rate base of \$58,000,000 and a rate of return of 4%.

(ii) Ratio of funded debt to net property—less than 60%. This test is met if either return is allowed.

(iii) Ratio of net property to operating revenues—less than 500%. This test is met if either return is allowed.

(iv) Ratio of depreciation and maintenance to operating revenues—15% or more. This test is met if either return is allowed.

(v) Ratio of income before charges to the par value of funded debt—12% or more. This test requires a gross income of \$4,800,000, and would not be met if either return were allowed.

(vi) Ratio of net operating income to net property—around 7%. This test would not be met if either return were allowed. This test really means a return of 7% on the depreciated rate base. As applied to electric utilities this test is much too high, but is met by PEPCo.'s present return.

³¹¹ Published by the New York State Bankers' Association.

(vii) Ratio of net income to operating revenues—19% or more. This test would not be met if either return were allowed, but is almost met by the present net income.

What the Company actually meant was that it desired a return which would meet all seven tests for the AAA rating of bonds. But this is by no means necessary. If the Company had a return of 5% based on original cost, the first four of the seven tests would be satisfied and would entitle the Company's bonds to a AAA rating. It may also be observed that although a 4% return on a prudent investment rate base of \$58,000,000 would satisfy only the second, third, and fourth tests, the Company's bonds should still be rated AAA.

After all, the bondholders' investment in this Company, which is \$40,000,000, is protected by assets having a depreciated cost of almost twice the amount. The income of the Company has always been, and is bound to be, sufficient not only to pay interest on the bonds and dividends on the preferred stock, but also ample dividends on the common stock. *The returns on these investments are guaranteed.* True, in the course of the hearing, Counsel for the Company asked: "Guaranteed by whom?" and the Chairman remarked: "Exclude this Commission as a guarantor."³¹² But neither the question nor the remark was pertinent. A pertinent question would have been "Guaranteed by what?" And the appropriate answer would have been that where annual rate adjustments are made with the view that a company earn over and above all expenses, depreciation and taxes, an amount sufficient to pay interest on the bonds, dividends on the preferred stock, reasonable dividends on common stock, and something to be passed to surplus, this procedure acts as a guaranty of the Company's return sufficient to pay interest on the bonds. It is by far a more effective guaranty than all the seven tests put together, where annual adjustments in the rates are not made. In these circumstances, if there is any meaning in the rating of bonds, such bonds must be rated AAA, quite irrespective of any ratios.

³¹² Tr. p. 3720.

Let us suppose, however, that the agencies engaged in rating securities do not agree with these views. Then the question arises: Why should the ratepayers be burdened with additional charges so that the Company's bonds might have the highest rating? The answer may appear to be simple. It is said that the higher the bond rating, the less is the cost of bond money to the Company, and the saving inures to the ratepayers, since their rate of return is computed upon the cost of money to the Company. But then the further question arises: At what price does the Company obtain this AAA rating, and how much must the ratepayers pay for it?

In this connection, it must not be overlooked that the rate allowed as the cost of the Company's bond money is 3.008%. This is already more than the cost of AAA bond money at the present time. It is greater than the cost of recently issued AA bonds. It is less by approximately $\frac{1}{4}\%$ than for A bonds issued in 1942, but it is approximately the same as the cost of A bonds issued in 1943. It is less by only $\frac{1}{2}\%$ of Baa bonds issued during 1942 and 1943.²¹³ Let us suppose, therefore, that of the \$38,000,000 of securities to be issued in the next ten years, the Company will want to issue as much as \$15,000,000 in bonds. If the high ratio between gross earnings and the income deductions is not maintained, and if those responsible for rating securities would rate the new bonds as low as Baa instead of AAA, this would mean an additional cost to the Company of $\frac{1}{2}\%$ of \$15,000,000 per year, an additional cost of \$75,000 per year. In order to avoid this additional cost, the Company in effect maintains that its return should be approximately \$3,000,000 more per year, and the cost to the consumers should be not only these \$3,000,000 but also the taxes which the Company must pay on this additional amount. In other words, in order to save the Company \$75,000 the ratepayers must pay \$5,000,000 per year. This is, indeed, too high a price to pay for a bond-rating formula.

D. Annual rate adjustments

The final question in this case is, what method should be employed in adjusting rates annually so that the Company

²¹³ Exh. 23.

would always be assured of a fair return and the public would be assured of fair and reasonable rates? Stated another way, the question is: What should be done with the earnings in excess of what the Company is entitled to, and what should be done to enable the Company to make up deficiencies, should deficiencies in earnings occur?

There is a question preliminary to the above, and that is: What constitutes an excess or deficiency? It will be noted that in this case, as in proceedings under the sliding scale arrangement, the computations were made upon the figures of the year preceding the year for which the rates are set. If the rates for 1944 are determined upon a 1943 rate base, as also upon the operating revenues, expenses, depreciation and other income deductions (except Federal income taxes) for that year, the excess or deficiency in earnings must be determined at the end of 1944 upon the analogous date for that year. This, in effect, is the theory behind the present sliding scale arrangement, but fallaciously applied. The applicable return computed at the beginning of the year must therefore be regarded as *tentative*, until the computations can be made at the end of the year upon actual data available as to the rate base, revenues and deductions therefrom, if no resort is to be had to estimating the rate base, revenue, expenses, etc., for the rate year.³¹⁴

Where, however, the return is computed upon a prudent investment rate base, i. e., upon the capital honestly and prudently invested, the problem is much simpler. The rate base remains the same, both at the beginning and at the end of the year. In fact, it does not change at all until securities are retired or additional securities are issued. This may happen once every few years, and, therefore, no adjustments in the rate base need be made every year. Of course, the return earned may be affected by changes in operating revenues, expenses, or other income deductions. To that extent, therefore, it is necessary to determine at the end of each rate year whether the return was excessive or deficient. To guard against a de-

³¹⁴ To avoid obvious inequities, this is what I suggested in the 1943 gas rate case. See Order No. 2682, p. 26.

ficiency in earnings, it is advisable not to hew too close to the line, but to figure on a gross revenue which, in all probabilities, will yield something more than the allowed return, provided that the "something more" will inure to the benefit of the public. This is exactly what was done in the computation made which resulted in a reduction in gross revenue by only \$5,000,000. With such a reduction, it is to be expected that the gross revenue for 1944 would be approximately \$17,530,000, plus such additional revenue as might result from increased sales of electric energy. Since the evidence shows that the business of the Company is on an upward trend, this is a reasonable expectation. These additional earnings resulting from additional revenue would be sufficient to absorb any incremental costs involved in the additional sales of electric energy and would also provide an excess over the allowed net return of \$2,320,000.

We, therefore, come to the main question: What disposition should be made of the excess earnings over the allowed return? As has been indicated, under the sliding scale arrangement as embodied in the Consent Decree, it was expected that the rates would be so fixed as to yield a net return equal to the product of the rate base and the rate of return allowed, but that one-half of the excess should be treated as having been earned for the next year. Instead, the gross revenue of the preceding year was reduced by one-half of the excess earnings in the preceding year, and the rates were computed on the difference. It was assumed that there would be no increase in business during the rate year, and then it was assumed that whatever earnings do result from increase in business should inure entirely to the benefit of the Company, although the costs involved are paid entirely by the ratepayers. It is elementary that such a method was bound to result in unreasonableness and excessive returns.

A further error in this rate-making formula lay in the assumption that if the earnings, and consequently the rates, in one year were excessive, and therefore unlawful, the allowance of reasonable earnings, plus one-half of the excess for the preceding year plus as much more as the rates thus established would yield on account of an increase in business, would render the

return and the rates just and reasonable, and therefore lawful. That this was not so, was amply illustrated by the application of this formula during the first year or two under the sliding scale arrangement. Surely by 1930 or 1931 it became evident that the deduction of one-half of the excess net earnings from the gross revenue of the preceding year, as a means for establishing just and reasonable rates for the succeeding year, was a snare and a delusion. There was really never any justification offered for this method of rate determination, except the fact that such was the formula pursued in the determination of rates under the sliding scale arrangement. The formula was worshipped as a force higher than the requirements of Congress and all laws relating to rate making. The absurdity of the application of this formula comes into bold relief when the return in any one year is supposedly reduced, yet the public is not given the advantage of the tax savings, nor of the increase in business, which follow such a reduction. In these circumstances, the "reduction" is simply a misrepresentation.

In the 1943 gas rate case ³¹⁵ I suggested a method of dealing with excess earnings where the rates are based upon the property devoted to public use. The method is much simpler than the formula under the present sliding scale arrangement and proceeds upon sound rate-making principles. If the reasonable return for a given year is determined, and it need not necessarily be determined as the lowest possible return, then any amounts earned in excess of the allowed return should be considered as being earnings subject to refund. To avoid the difficulties involved in refunding earnings, I suggested that the excess earnings be set up in a special reserve and should be considered as customers' contributions to the Company's plant. Likewise, in case of a deficiency in earnings for a given year, the amount may be considered as still owing to the Company from the rate payers, and, to avoid the difficulties of making an additional charge against the consumers, the amount may be subtracted from that special reserve. In this manner, the rate base, diminished by the net amount in the special reserve, would automatically yield the proper reduction in rates. Any failure to calculate with a high degree of accuracy in one year so that

³¹⁵ Order No. 2682, p. 28; see, also, Tr. pp. 82-84.

the consumers do not receive as great a reduction as they are entitled to would reflect itself in the computations made at the end of the year, and such error would be automatically corrected. In this manner, the excess earnings would redound both to the Company and to the public. They would inure to the benefit of the Company, because the excess earnings would be retained in the business. They would inure to the benefit of the public, because they would be considered as their contributions to plant with a consequent reduction in rates. They would inure to the benefit of the investors, because they would make the returns more certain, and again they would inure to the benefit of the public, because, with the elimination of the risks and uncertainties in the investment, the cost of money, upon which the rate of return is computed, would naturally be reduced.

In the course of the present hearing several witnesses testified and recommended that a part of the excess earnings should be left with the Company as an "incentive."³¹⁶ By some esoteric process they figured that additional profits would, in some manner, result in greater efficiency, expansion of service, and, consequently, in added benefits to the public. However, even Dr. Bonbright, who strongly advocated that a part of the excess earnings should be allowed to the Company as an incentive, pointed out that the allowance of excess earnings simply meant that these additional sums would inure solely to the benefit of the common stockholders, and that in a modern corporation of any considerable size the common stockholders contribute nothing to the efficiency or expansion of the service of the corporation. This is especially so in this case where the common stock is held by a corporation which renders no services to the operating utility and its only efforts are exerted to receive dividends and pass them on to another corporation, the North American Company, which also contributes nothing by way of services or efforts to PEPCo., but only receives and distributes dividends.

Despite all this, Dr. Bonbright suggested that earnings in excess of the reasonable return allowed should, in part, be re-

³¹⁶ Tr. pp. 108-116, 695-7, 1870-4, 2022-3, 2248-62.

tained by the Company in order to enable it to expand its service for the public and to practice economies. It is difficult to see how excess earnings would have such beneficent results. A public utility is under a duty to develop its service and to serve the public at just and reasonable rates. That is why a public utility is said to be entitled to all operating costs, recoupment of its investment through annual depreciation charges, to all of its other income deductions, and to a reasonable return.³¹⁷ As Dr. Bonbright himself suggested, the allowance of excess earnings would be in the nature of a bribe to induce the public utility to do that which it is already under an obligation to do.

But, aside from these ethical considerations, if the expansion of service resulting from excess earnings takes the form of additions to plant, then the allowance of these excess earnings is simply another way of making the ratepayers pay for the Company's plant. If that is so, the plant should be owned by the ratepayers, not by the corporation. At least, these amounts should be regarded as contributions to plant, which, of course, would mean that these amounts should be deducted from the rate base and the result would then be the same as in the plan, suggested above, namely, to set up a special reserve, the net balance of which might be deducted from the rate base for the purpose of computing reasonable rates for the succeeding year.

Let us suppose, however, that it is not intended that the development of service is to be in the nature of additions to plant from excess earnings, but that the excess earnings would be an incentive to develop the Company's service and to increase its efficiency in some other way. The question then arises whether there is any basis for this assumption. With PEPCo. having retained excess earnings of gigantic proportions, one would expect that when it obtained an interest in the Great Falls power site it would develop that site for the benefit of the people of the District of Columbia. For what other purpose would an electric operating company obtain and retain an interest in a power site? It appears, however, that although PEPCo. had this interest for over 30 years, and has paid out over \$8,500,000 in dividends on the stock issued for

³¹⁷ It is not entitled to such a return if it does not operate efficiently and economically. See order No. 2564, pp. 54-5.

this interest in the power site, it has not been developed for the purpose of benefiting the people of the District of Columbia. It would appear rather that the site has been retained for the purpose of preventing anybody else from developing it for the purpose of generating electric energy. This is hardly in accord with the assumption that excess earnings are an incentive for the development of service to the public.

Nor is there any evidence that the gigantic excessive earnings retained by PEPCo. have rendered it any more efficient than other electric companies of comparable size in the sense that its operating expenses are lower. The Chief Accountant presented some comparative data between PEPCo. and ten other electric operating companies, whose electric operating revenues, kilowatt hours sold, and electric plant in service were, on the average, substantially the same as those of PEPCo. The operating revenue deductions, however, do not reflect any greater efficiency than that of the average of the other operating companies. In fact, the operating expenses are substantially the same, except that PEPCo.'s transmission expenses are very much less, but this is accounted for by the fact the PEPCo. operates in a concentrated area and is bound to have very little transmission expense.³¹⁸

In view of these facts, there is no reason why any excess earnings over and above a fair return should inure to the benefit of the Company. The excess earnings, it must not be overlooked, result solely from what may properly be called an error in estimating the earnings for the year, and this gives no right to the utility to benefit from them. Therefore, whatever be the method of arriving at a fair and reasonable return, any earnings in excess of that amount should be devoted entirely to the public benefit.

The prudent investment theory of rate making proceeds on the assumption that the investors are entitled to a reasonable return on their actual investments and that the public is entitled to reasonably efficient service. The utility corporation is under a duty to the public to render such service; it is under a duty to the investors to pay interest on the bonds, dividends on the preferred stock, and reasonable dividends on their in-

³¹⁸ Exh. 3, Sch. 3.

vestment in common stock, and so to comply with its duties to the public, through efficient management, that these payments to the investors will be safeguarded. In this view, if the payments on the senior securities are fixed by contract, and reasonable dividends on the common stock are fixed and determined by the Commission, the earned surplus should be limited to its proper function of safeguarding these payments to the investors, in case the return in any one year should fall below that necessary to meet these payments. However, the earned surplus of PEPCo. has already reached gigantic proportions and is sufficient to absorb losses for many years to come. Therefore, the question as to what should be done in case of an earnings deficiency is entirely academic. The problem is to institute a sliding scale method which would guarantee payments to the investors and gradually reduce the earned surplus to a point where it would serve its proper function.

With these considerations in mind, the following method is suggested:

(1) *That the common stock capital be reduced to \$5,245,000 and that the dividends on the common stock be fixed at 7½% per annum on this amount actually invested in such stock, and that the Company be limited to the payment of such dividends until further order of the Commission.*—The evidence shows that the earnings-price ratios of electric utility common stock are between 6% and 7%. The market price of the stock, together with the dividend rate, may be a measure for encouraging purchase and sale of stock on the market, but it is in no sense a measure for attracting common stock money to the utility. The function of the Commission is not to allow a return which would provide a fruitful field for speculative dealing in utility securities, but to allow a return which would attract honest investment in the utility corporation. Therefore, the return must be based on the amount which the corporation receives for its common stock, not the amount which one receives for the stock after he has invested in the utility corporation and desires to dispose of his investment to someone else. If a 6% or 7% return is sufficient to attract investment in common stock on the stock market, with the attendant hopes of selling the stock for more, and as often with the disappointing fact

that it is sold for less, a $7\frac{1}{2}\%$ dividend is surely sufficient to attract common stock to the corporation itself, without the hope of earnings on an unearned increment in the value of the stock. If the corporation is not entitled to earnings of the unearned increment in the value of its property, then surely the investors are not entitled to earnings on any unearned increment in the value of their securities. In this respect, the position of the common stockholder should not be different from that of the bondholder or of the preferred stockholder.

True, PEPCo's, bonds bearing interest at $3\frac{1}{4}\%$ now sell on the market at about \$110, which may mean that $3\frac{1}{4}\%$ is too high a price to pay for this bond money, and that approximately 3% would be sufficient. True, also, the \$100 par value preferred stock, bearing dividends of 6% or $5\frac{1}{2}\%$, is now selling at \$110, which may also be an indication that the cost of the preferred stock money is too high. But neither the bondholders nor the preferred stockholders can lay any claim to a return on \$110, when they actually put \$100 into the corporation. The fact that these investors are willing to trade their rights to receive \$3.25, \$5.50 or \$6.00 on the original investment for something more, does not mean that either the utility or the public should pay proportionately more for the money actually invested in the corporation.

The same principle applies to the common stock. The fact that PEPCo.'s common stock might sell at one figure or another on the market does not obscure the fact that PEPCo. received at most an equivalent of \$5,245,000 for its common stock and that this is the amount on which it must pay reasonable dividends. The fact that dividends are based on this amount will not repel future investments in common stock. On the contrary, investors will be only too glad to put their money into PEPCo. common stock with the expectation of receiving $7\frac{1}{2}\%$ on the amount actually invested by them. If they do so invest their money, and if they then sell the stock to someone else who might be willing to pay as much as \$110 or \$120 per share, no argument can possibly sustain the proposition that the public should, therefore, pay $7\frac{1}{2}\%$ on the \$110 or \$120, rather than on the \$100 actually invested.

2. *That a stabilization fund in an amount equal to one year's return be set aside out of earned surplus (in cash or property readily convertible into cash) for the purpose of meeting any deficiency in earnings necessary to pay interest and dividends.*—It is said that the common stockholder is not in the same position as the bondholder or preferred stockholder because his is a greater risk. The concept of risk is a very tenuous one and most of it more imaginary than real. It must be admitted that if there is anything to the proposition that a common stockholder is entitled to higher return than a bondholder or preferred stockholder because of the greater risk involved, then the risks of WRECo. must have been extraordinarily great to have justified dividends of about \$42,000,000 in 17½ years on an investment of \$2,245,000 (on the average of over 100% per year) and about \$5,000,000 in 1½ years on an investment of \$5,245,000 (on the average of 60% per year), when investors in common stock of electric utilities generally are quite content with 6% or 7% on their money.³¹⁹ However, if common stockholders are entitled to a higher return because of the greater risks, then the function of the Commission is not to heap costs on ratepayers to compensate investors for such greater risks, but to do everything possible to reduce the risk to a minimum. It has already been shown that the sliding scale method of rate regulation acts as a virtual guaranty of reasonable dividends on the common stock.³²⁰ In such circumstances, the common stockholder cannot be said to have a risk much greater than the bondholder or preferred stockholder. However, if that is not so, the establishment of a stabilization fund in an amount equal to one year's return at the beginning of each year to safeguard against any deficiency in current earnings to meet as much as 7½% on the common stock, after payment of interest and preferred stock dividends, would certainly serve to diminish any risk, real or imaginary, on the part of the common stockholders.

Let us see how this would work. At the end of 1943, the balance sheet shows, the Company had on hand approximately \$1,825,000 in cash, \$3,000,000 in temporary cash investments

³¹⁹ Comp. Tr. pp. 1855-6.

³²⁰ See, also, Tr. pp. 1865, 3720.

and \$400,000 in receivables from associated companies. In other words, over \$5,000,000 in cash or property easily convertible into cash. Out of this amount, a fund of \$2,320,000, equal to the allowable return for 1944, could be set aside. With the reduction of \$5,000,000 in gross revenue, and with rates computed accordingly, the net operating income for 1944 is bound to be more than \$2,320,000, because the Company's business is definitely on an upward trend.³²¹ Let us suppose, however, that for some unforeseen reason the net operating income will drop below \$2,320,000. This amount is already more than necessary to pay interest on the bonds—\$1,300,000,³²² dividends on preferred stock—\$395,000³²³ and 10% dividends on common stock—\$524,500, a total of \$2,219,500. In other words, the obligations would be met even if the return fell by as much as \$100,000 per year indefinitely, without drawing on the stabilization fund. Even if it be assumed that the return would fall by as much as \$200,000 per year, and the stabilization fund were kept at the level of a year's allowable return by transfers from earned surplus, then the dividends would be guaranteed indefinitely (for over 250 years). Where can one find such a guaranty for any type of security, be it common stock, preferred stock or even AAA bonds?

(3) *That if the return earned in any one year exceeds the return allowed, then one-half of the excess shall be considered as having already been earned for the following year, and the rates should be so fixed as to yield as nearly as practicable the allowable return, less one-half of such excess.*—It must be recognized that the return for 1944 will be greater than the allowed return of \$2,320,000, and, as has been indicated, the difference between the return earned and the return allowed will not be due to any factor which might entitle the Company to more than the allowable return, or which might entitle the investors to additional profit. The difference will be due entirely to the tentative character of the present rate determination. If, because of this tentative element in rate determination, the rate

³²¹ See also, budget estimates for 1944. Exh. 42 and 43, Tr. pp. 1451-1464, 1664-85.

³²² Exh. 26, Sch. 2.

³²³ Exh. 26, Sch. 3.

for any one year exceeds the return allowed, the difference rightfully belongs to the ratepayers. It should either be returned to the ratepayers or it should be kept by the Company for the benefit of the ratepayers. In these circumstances, one-half of the excess earnings may properly be considered to constitute advance payments for service to be rendered in the following year, and the rates for that year should be fixed accordingly. For example: If the rates for 1944 yield a return of \$200,000 in excess of \$2,320,000, then \$100,000 should be treated as earnings for 1945, and the rates fixed for that year should be calculated to yield a net return of \$2,220,000.

(4) *That the other half of the excess earnings, plus the excess in the allowed return over and above that necessary to pay interest and dividends, shall be used, subject to the direction of the Commission, for the retirement of outstanding obligations, additions to plant, application to depreciation, maintenance or expense, or for such other purposes as would inure to the benefit of the ratepayers.*—Since the Company is not entitled to any part of the excess earnings, the second half of the excess should also be applied for the benefit of the public. If the excess earnings are used to retire outstanding obligations, the rate base is thereby diminished, and so also is the allowable return. If any part of the excess earnings are put into plant, such additions should be made with the clear understanding that they are the customers' contributions to plant, and that in no circumstances are the investors entitled to any return on those contributions. If there is no need for the retirement of outstanding securities or for additions to plant, the excess earnings may be applied to augment the depreciation reserve, or to the annual accrual for depreciation or to repairs and maintenance, thereby reducing the cost of operation for those years. So long as the earned surplus is greater than necessary to safeguard the common stock capital, no part of the excess earnings should be added to earned surplus.

(5) *That if the return in any one year falls below the allowed return, to the extent that it is necessary to draw materially on the stabilization fund, and further additions to this fund out of surplus are found by the Commission to be inappropriate, then the rates should be so increased as to meet the allowed return.*—

With the suggested reduction of \$5,000,000 in gross revenue, the rates will still yield large excess earnings over and above the allowed return. The object of this limited reduction is to avoid changes in the rate structure which would be too abrupt.³²⁴ Further rate reductions will have to be made to bring the earnings of the Company to the level of reasonableness, to absorb the one-half of excess earnings, in accordance with the immediately preceding paragraph, and to absorb so much of the present earned surplus as to reduce it to its proper function of safeguarding the common stock investment. The proper relationship between the surplus and the common stock investment will have to be determined. Yet, it is evident that while a surplus of as much as \$5,000,000 may be necessary and proper to safeguard a common stock investment of \$30,000,000, it is neither necessary nor proper to have a surplus of \$30,000,000 to safeguard a common stock investment of \$5,000,000. The present abnormal relationship between surplus and the common stock can be reduced either by the issuance of additional common stock or by charging deficiencies in earnings against surplus or by both such methods. In this view, there will be no occasion to invoke the operation of the suggestion involving rate increases for many years to come.

(6) *That the rate base, the rate of return, the allowed return and the stabilization fund should be redetermined whenever there is a substantial change in the outstanding securities.*—The sliding scale method suggested herein is indeed very simple. It is not necessary to have an annual determination of the rate base. Since the rate base is the capital invested in the Company's securities, it remains constant so long as no securities are retired or additional securities issued. Small changes in the outstanding securities will not materially affect either the rate of return or the return. When a substantial change takes place in the outstanding securities, however, especially when the relationship between the various classes of securities is substantially altered, there may not only be a change in the rate base, but also in the cost of capital or the rate of return. Then it is necessary to make a redetermination. Until then the application of

³²⁴ This is by no means a violent change. See Tr. pp. 2018-9.

this sliding scale method requires only computation of the excess earnings and their application to rate reductions in accordance with the foregoing suggestions.

This should enable the Commission to devote considerable attention to the Company's expenses, a phase of rate regulation thus far almost entirely neglected. As I said in another connection: ³²⁵

* * * a utility is not entitled to any and all expenses it may incur, if the public is to pay them by way of rates.

The determination of fair and reasonable rates must, therefore, also involve supervision and regulation of expenditures, for, in the last analysis, the utility is dealing in the public's funds.

GREGORY HANKIN,
Commissioner.

JUNE 23, 1944.

In The District Court of the United States
for the District of Columbia

Civil Action No. 26401

UNITED STATES OF AMERICA, PETITIONER

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
ET AL., DISTRICT BUILDING, WASHINGTON, D. C., RE-
SPONENTS

Answer of Respondents, Public Utilities Commission

Come now the Respondents, Public Utilities Commission of the District of Columbia, and James H. Flanagan, James F. Reilly, and Charles W. Kutz, constituting the Public Utilities

³²⁵ *The Future of Public Utility Rate Regulation*, 33 Public Utilities Fortnightly, 135, 138 (March 3, 1944).

Commission of the District of Columbia, Respondents in the above-stated action, by their attorneys, and for answer to the Petition of Appeal therein say:

FIRST DEFENSE

The Petition of Appeal fails to state a claim against the Respondents, upon which relief can be granted.

SECOND DEFENSE

1. They admit the allegations contained in paragraphs 1, 2, 3, 4, and 5 of the Petition of Appeal.

2. They deny the allegations contained in paragraph 6 of the said Petition, and for further answer thereto say that all of the common stock issued by Potomac Electric Power Company (hereinafter referred to as "PEPCO") has been owned by Washington Railway & Electric Company since such stock was issued, to wit: in 1896, 1902, 1912, 1925, and 1942.

3. In answer to paragraph 7, the Respondents say that the allegations contained therein are irrelevant and immaterial and require no answer.

If answer be required, the Respondents say they are without knowledge or information sufficient to form a belief as to the truth of the allegations set forth in said paragraph. They allege that in 1943 the North American Company owned 34.55% of the voting stock of the Washington Railway & Electric Company.

4. They admit the allegations contained in paragraph 8 of the said Petition.

For further answer to the said paragraph, the Respondents say that the common stock represents a very small part of the common stock equity invested in the property of PEPCO.

Further answering paragraph 8 of the said Petition, the Respondents allege that the Commission's witness and the Commission made various adjustments in the common capital account (common stock equity) and deleted therefrom all inflationary items (including those set forth in paragraph 8 of the Petition) not representing actual investments by the common stockholder, as shown on page 35 of the Commissions' Findings. The inflationary items eliminated from the Com-

pany's plant account as a result of the reclassification in accordance with orders issued by the Federal Power Commission and the Respondent were charged to earned surplus, thereby making whole the investment recorded in the common stock capital account.

Further answering the said paragraph, the Respondents say that in the study of the cost of capital for the determination of the basic rate of return, the Commission likewise eliminated from the common stock equity all inflationary items and the stock issued for Great Falls power site.

5. The allegations set forth in paragraph 9 are immaterial and irrelevant, and Respondents are not required to answer. But if answer be required, the Respondents admit that PEPCO and the Commission were engaged from 1917 to 1924 in litigation with respect to the value of PEPCO's property, and the rates to be charged for its services, as alleged in paragraph 9 of the Petition, and that such litigation terminated December 31, 1924, upon the entry of a decree consented to by the parties, which is commonly referred to as the Consent Decree. Reference to the decree is referred to for a more complete statement of what it contains. The sliding-scale plan was found by this Court in the Consent Decree to be "fair and reasonable, and made with the approval of the Court."

For further answer, the Respondents say that prior to the litigation beginning in 1917 the Commission had been engaged for several years in an investigation of the value of the property of PEPCO, and that such prolonged investigation and litigation occurred prior to the adoption of the sliding-scale plan, and that since the adoption of the sliding-scale plan, the Company's property has been valued pursuant to the said plan with a minimum of time and expense to the rate-payers, and rates have been fixed annually in accordance with the provisions of the said plan.

6. In answer to the allegations contained in paragraph 10 of the Petition, the Respondents say that the volume of PEPCO's sales and the net earnings available for dividends for the years 1925 to 1930, inclusive, are not involved in the order appealed from and are not relevant or material to this

appeal, and Respondents are not required to make answer thereto.

But if answer be required, the Respondents allege that because of the increased volume of sales and the economy in operation, the Commission found that PEPCO was making excess earnings, and in 1931, after issuing its order of investigation, statutory notice of hearing, and a public hearing, issued its Order No. 919, modifying the sliding-scale plan so as to reduce the basic rate of return.

The Respondents admit that they did not construe and apply the Consent Decree in such manner as to actually use any portion of the excess earnings of the Company as a "refund" to the rate-payers, because such construction and application would have been contrary to the Consent Decree:

The Respondents deny the allegation in paragraph 10 that the Commission did not require the Company to "absorb any portion of the excess of any year during the following year." For further answer to the said allegation, they allege that the sliding-scale arrangement contained in the Consent Decree of this Court, provided that a portion of excess earnings—

"shall be used in a reduction of rates to be charged the public for electric service thereafter, * * *; that is to say, by way of example, if the return for any one year should amount to \$100,000 over and above 7½ percent on the base ascertained as aforesaid then the rates for the succeeding year to be charged the public shall be automatically reduced by the filing of new rate schedules to absorb \$50,000 of such excess during such year."

The Respondents further allege that the precise method approved and ordered by this Court has been followed by the Commission throughout the life of the sliding-scale arrangement.

The Respondents deny that in the application of the sliding-scale plan, the volume of sales and expenses were assumed to be the same as in the test year, as alleged in paragraph 10 of the Petition.

7. In answer to paragraph 11, Respondents say that Order No. 919, promulgated on June 8, 1931, is not material to this

appeal, and no answer is required thereto. But if answer be required, the Respondents deny that the Commission in its Order No. 919 stated that "the rate of return yielded by the sliding-scale is excessive and unreasonable," and allege that the said Order No. 919 was promulgated after the Commission had ordered an investigation of the provisions of the sliding-scale plan. After notice and hearing thereon, the Commission issued its Order No. 919, in which it found that the rate of return earned under the "existing sliding-scale" was excessive, and modified the said plan by reducing the basic rate of return from 7-1½ to 7%.

For further answer to the allegation that Order No. 919 codified an erroneous interpretation of the Consent Decree, the Respondents allege that PEPCO appealed from Order No. 919, and this Court modified the said Order on July 27, 1932, in Equity No. 53475, and that the sliding-scale plan promulgated in the Consent Decree in 1924 was modified by this Court in the said Equity No. 53475, and that the plan, as so modified, was followed and applied thereafter until the Commission further modified said plan in 1935 and 1937 by again reducing the rate or return after an order of investigation and notice and public hearing in each proceeding. They further allege that in the said decree of July 27, 1932, this Court modified Section 4 of the sliding-scale plan promulgated in the Consent Decree to read as follows:

"(4) If the rates hereafter yield more than 7 percent in any 12-month period, on the rate base for that period, determined as aforesaid, the excess over and above the said 7 percent shall be used in a reduction of rates to be charged the public for electric service thereafter as follows:

"If the amount earned is above seven percent (7%) and less than eight percent (8%) of the rate base, rates for the following 12 months based upon the business done during the 12 months in which such excess occurred shall be adjusted so that the gross receipts of the Company shall be reduced by one-half (½) of such excess: if the amount of the return is in excess of eight

percent (8%) and less than nine percent (9%), an additional amount of three-fourths ($\frac{3}{4}$) of the said excess above eight percent (8%) shall be used for the reduction of rates; if the amount earned is in excess of nine percent (9%) a further additional amount of five-sixths ($\frac{5}{6}$) of the excess above nine percent (9%) shall be used in like manner for the reduction of rates."

The Respondents admit that the Commission did not issue interim orders designed to "recapture" any of the excess earnings under the sliding-scale plan, as alleged in paragraph 11. Further answering the said allegation, the Respondents say that the sliding-scale plan does not provide for the "recapture" of excess earnings, and that an order attempting to "recapture" excess earnings would be in violation of the decree of this Court entered July 27, 1932, signed by the late Mr. Justice Luhring in Equity No. 53475.

The Respondents deny that the net revenue of the Company has in each year except 1941 been in excess of calculated net revenue and for further answer, they say that the sliding-scale plan does not provide for a forecast of expected revenue, and therefore, no such "calculation" was made by the Commission. They allege that in conformity with the provisions of the sliding-scale arrangement computations were made of the net revenues of each "test year" for use in determining net income available under the arrangement for rate reductions. They deny the allegation that there was no determination by the Commission as to the accuracy of an alleged loss in 1941, as alleged in paragraph 11 of the Petition. For further answer to the said allegation, the Respondents say that a determination was made by the staff of the Commission, and that the rate of return earned by PEPCO during the year 1941 was found to be less than the basic rate of return provided for in the sliding-scale plan.

The Respondents deny the remaining allegations in paragraph 11 of the said Petition.

8. The Respondents deny the allegation in paragraph 12 of

the Petition that PEPCO's surplus of \$29,000,000 was derived from excessive rate payments.

For further answer to paragraph 12, the Respondents say that the allegations in respect of the annual net earnings and annual dividends actually paid on "par value" of outstanding common stock during the period 1925 through 1942 is only a partial statement of the investment of the common stockholder in the property of PEPCO. The Respondents say that the use of only a part of the investment of the common stockholder in determining the earnings and dividend percentages there alleged results in a distortion of the facts. They allege that the record shows annual net earnings on the common stock equity from 1925 to 1942 ranged from 9.89% to 31.97%, and that the average net earnings in the said period was 14.44%; that the annual dividends on the common stock equity ranged from 6.34% to 11.49% during the said period.

For further answer to the tabulations contained in Appendices "B" and "C," the Respondents allege that the said tabulations are conclusions of the pleader, and require no answer. But if answer be required, the Respondents say that the computations shown thereon are predicated on only a portion of the investment of the common stockholder, and grossly overstate the relation of earnings and dividends to the investment of the common stockholder.

9. The allegations contained in paragraph 13 are arguments and conclusions of the pleader, and are not material or relevant, and therefore require no answer.

But if answer be required, the Respondents allege that the net earnings of PEPCO under the rates established by Order No. 2564 were $7\frac{3}{100}$ of 1% in excess of the basic rate. They further say that the allegations respecting net income for 1943 available for common stock dividends, and the percentage of common stock, and the amount invested in common stock, do not represent the percentage relation of earnings and dividends to the total investment of the common stockholder.

10. In answer to paragraph 14 of the Petition, the Respondents say that the allegations set forth therein have no relation

to the matters on appeal, they contain arguments and conclusions of the pleader, and no answer is required.

But if answer be required, the Respondents say that the sliding-scale plan, as modified by Order No. 2796, from which this appeal is purportedly taken, does not provide for interest on the depreciation reserve. They deny that PEPCO received any earnings on its depreciation reserve and that, on the contrary, PEPCO paid 4% interest annually on the said reserve in the form of a deduction from the annual accrual for depreciation as provided by the decrees of this Court entered 1924 and 1932. For further answer, the Respondents say that the Petitioner herein made the same contention and the same argument before the Supreme Court of the United States in *Vincent et al. v. Washington Gas Light Company et al.*, and the Supreme Court rejected the arguments as "unsupported" by its cases (321 U. S. 489).

11. The Respondents admit the allegations contained in the first five sentences of paragraph 15 of the Petition. For further answer, they say that as of June 30, 1944 (the date of retirement of the third member of the Commission), the Commission's Findings, Opinion and Order had not been agreed upon and they were not issued until July 22, 1944.

For answer to the remaining allegations in the said paragraph, the Respondents admit that the retiring third member of the Commission filed a memorandum relating to the proceedings (Appendix "D"), but they deny that such memorandum has official status, or that it would be of value and assistance to this Court, as there is grave doubt that the retiring member could have, in any event, participated in the determination of the proceedings since he appeared and testified under oath as a witness therein, and further because the conclusions there stated are not supported by the record.

12. The Respondents admit the allegations of paragraph 16 of the Petition. For further answer, the Respondents say that the data contained in the exhibit marked number 74 for identification were incompetent, irrelevant, and not related to the investigations being conducted by the Commission and were,

therefore, properly rejected. They deny the truth of the matters set forth in paragraph 16 as reasons for the admission of the said proposed exhibit.

For further answer, the Respondents say that the matter alleged in paragraph 16 as the reasons for offering the proposed exhibit in the proceedings before the Commission were the subject of a separate investigation instituted by the Commission, which investigation is still pending, and which matters were submitted by the Commission to the Department of Justice for opinion.

13. The Respondents deny each and every allegation contained in paragraph 17 of the Petition.

14. The Respondents deny each and every allegation contained in the Petition of Appeal not herein specifically admitted, qualified, or otherwise pleaded.

Wherefore, having fully answered the Petition of Appeal herein, the Respondents pray that the same be dismissed.

(S) RICHMOND B. KEECH,
Richmond B. Keech,

(S) LLOYD B. HARRISON,
Lloyd B. Harrison,

*Attorneys for the Respondents,
Public Utilities Commission.*

This is to certify that I have this 9th day of November 1944, served the foregoing answer by mailing copies thereof to the Attorneys for the Petitioner.

(S) LLOYD B. HARRISON.
Lloyd B. Harrison.

(Note: The answer filed by James Lauderdale, People's Counsel, was the same as the foregoing answer of the Public Utilities Commission.)

IN THE DISTRICT COURT OF THE UNITED STATES FOR THE
DISTRICT OF COLUMBIA

Civil Action No. 26401

UNITED STATES OF AMERICA, PETITIONER

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
AND JAMES H. FLANAGAN, JAMES F. REILLY, AND CHARLES
W. KUTZ, CONSTITUTING THE PUBLIC UTILITIES COMMISSION
OF THE DISTRICT OF COLUMBIA, RESPONDENTS

Answer of Potomac Electric Power Company

Now comes the respondent (intervenor), Potomac Electric Power Company, by its attorneys, answering the Petition of Appeal in the above-entitled proceeding, respectfully states as follows:

1. Denies that petitioner is a party affected by the decision and Order No. 2796 of the Public Utilities Commission of the District of Columbia, dated July 22, 1944, as alleged in the first unnumbered paragraph and the last sentence of paragraph 3 of said Petition of Appeal.

2. Admits paragraph 1, that part of paragraph 3 that alleges petitioner to be the largest consumer of the respondent, paragraphs 4, 5, 6, 9, and that part of paragraph 15 which alleges that said Commission by its Order No. 2565 ordered a certain investigation and that the Commission following hearings subsequent to such investigation issued its certain findings, opinion and Order No. 2796, which was signed by the then and existing members of said Commission, but denies that there was any minority report officially filed in, or made a part of, said case, and further denies the alleged minority report contains material of value and assistance to the Court, but, on the contrary, avers that said so-called minority report is irrelevant, immaterial, and incompetent, and should not be considered as an exhibit in this appeal, but should be stricken therefrom.

3. Admits that it is a corporation and a public utility and is subject to control and regulation as provided by the Act creat-

ing said Commission and as alleged in paragraph 2 but denies that the Order appealed from establishes reasonable, just and nondiscriminatory rates to be charged by respondent during the calendar year 1944.

4. Denies paragraph 7 and states that the same contains matter irrelevant and immaterial to the proper consideration of this appeal.

5. Admits the outstanding shares of stock of the respondent as alleged in paragraph 8, but denies each and all other averments of said paragraph.

6. Admits that the volume of respondent's sales increased and under the terms of the Consent Decree in effect during such period the net earnings available for dividends exceeded basic allowable rate of return as alleged in paragraph 10, if pertinent at this time, but denies each and all other averments of said paragraph.

7. Admits that the Commission issued its Order No. 919 reducing the basic allowable rate of return as provided for in the terms of said Consent Decree as alleged in paragraph 11 of said petition, but denies each and all other averments of said paragraph.

8. Denies paragraph 12 as set out in said Petition and avers that none of the said averments embrace matters that are material or relevant or such as may be raised in said Petition of Appeal.

9. Admits as alleged in paragraph 13 of said Petition that at the rate hearings held by the Commission in 1943 the petitioner was permitted to intervene and urged the abandonment of the sliding-scale arrangement, but denies each and all other averments of said paragraph.

10. Admits that interest has been accrued on the depreciation reserve as provided for by the terms of said Consent Decree as alleged in paragraph 14 of said Petition, but denies each and all other averments of said paragraph.

11. Denies that any error was committed by the Public Utilities Commission in the exclusion of Exhibit 74, and the so-called proof offered in support thereof, as alleged in paragraph 16 of the Petition. It further denies each and all other averments of said paragraph.

12. Denies that the rulings of the Public Utilities Commission as alleged in paragraph 17 of the Petition constituted error; and further denies that the petitioner has any legal rights to complain of, or object to, such rulings, or raise such questions by independent and separate appeal.

13. Avers that since December 31, 1924, its rates of charge have been fixed under a certain sliding-scale arrangement, the origin and nature of which is set forth in paragraph 3 of the respondent's Petition of Appeal (#25,477) to vacate Order No. 2796. The Commission by its Order No. 2565, dated April 26, 1943, ordered an investigation be made to determine whether the sliding scale method of regulating respondent's rates should be abandoned; whether it should be continued in its present form or with modifications of its basic elements. By Order No. 2703, dated January 5, 1944, the Commission ordered that an investigation be made relative to the rates, tolls, etc. of the respondent pursuant to the provisions of the sliding-scale arrangement as then constituted or as modified as a result of the investigation authorized by the above-mentioned Order No. 2565. On July 22, 1944, the Commission published its Order No. 2796, the Order from which the respondent petitioned for an appeal, and which the respondent claimed to be erroneous because the said Order was illegal and invalid in that it purported to establish by unilateral action and without the consent of the respondent a new sliding-scale arrangement for the determination of respondent's rates of charge, but not as provided for by Section 43-317, D. C. Code. That is the absence of the sliding-scale arrangement entered into pursuant to the aforesaid provisions of the Act, respondent's rates of charge must be fixed in accordance with the provisions of the Act otherwise applicable, all set forth in respondent's said Petition of Appeal, paragraphs 4 and 5, which are asked to be made by reference a part of this answer.

14. Avers that said Petition of Appeal herein fails to set forth any facts entitling petitioner to relief.

Wherefore, respondent, (intervenor) respectfully prays that this Honorable Court dismiss said Petition of Appeal and grant

such other and further relief as to the Court may seem just and proper,

BOWEN AND KELLY,
By S. R. BOWEN,
WM. K. LAWS,
Attorneys for Respondent
Potomac Electric Power Company,
929 E Street NW., Washington, D. C.

Copies of above Answer mailed to counsel for Petitioner and Public Utilities Commission of the District of Columbia this (8th) day of November 1944.

S. R. BOWEN.

In the District Court of the United States for the District of
Columbia

Civil Action No. 26401

UNITED STATES OF AMERICA

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
ET AL.

Order Dismissing Petition of Appeal

Upon consideration of the motion to dismiss the petition of appeal in the above entitled action, and after oral arguments thereon, it is this 29th day of January 1945,

Adjudged that the motion to dismiss the petition of appeal be granted and that the said petition of appeal be, and it is hereby, dismissed.

(S) J. FOSTER SYMES,
Justice Assigned.

Approved as to form:

(S) R. B. KEECH.
(S) JAMES W. LAUDERDALE.
(S) LLOYD B. HARRISON.
(S) S. R. BOWEN.

In The District Court of the United States
for the District of Columbia

Civil Action No. 26401

UNITED STATES OF AMERICA, PETITIONER

vs.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,

ET AL., RESPONDENTS

Statement of Reasons for Decision

The Court allows the Motion of Potomac Electric Power Company to dismiss the appeal of the United States because said Petition fails to state any facts (a) showing that Petitioner is a person or corporation affected by Order No. 2796 of the Public Utilities Commission of the District of Columbia from which it has filed said appeal, within the meaning of the Act of Congress approved March 4, 1913, as amended (Sec. 43-705, D. C. Code); (b) showing that the Petitioner has any interest entitling it to prosecute said appeal, or (c) entitling the Petitioner to relief herein.

Moreover the United States does not have any property right or such interest to file independent appeal where its only basis is that of a consumer of the Potomac Electric Power Company and the Court feels strengthened in this view by the amendatory provision in the Act creating the said Commission providing for a People's Counsel and prescribing his duties in respect thereto.

(S) J. FOSTER SYMES,
Justice (Assigned).

In the District Court of the United States for the District of
Columbia

Civil Action No. 26401

UNITED STATES OF AMERICA, PETITIONER

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
AND JAMES H. FLANAGAN, JAMES F. REILLY, AND CHARLES W.
KUTZ, CONSTITUTING THE PUBLIC UTILITIES COMMISSION
OF THE DISTRICT OF COLUMBIA, RESPONDENTS

**Order Granting Motion of Potomac Electric Power Company
for Leave To Intervene**

For good reason shown upon the motion of Potomac Electric
Power Company, it is by the Court this 27th day of October
1944,

Ordered that the motion of Potomac Electric Power Com-
pany for leave to intervene as a party respondent in the above-
entitled cause, be and the same is hereby granted.

(Sgd.) DAVID A. PINE,
Justice.

We consent to the entry of the above order.

(S) FRANCIS M. SHEA,
Attorney for Petitioner.

Attorney for Respondents.

In the District Court of the United States for the District of
Columbia

Civil Action No. 26401

UNITED STATES OF AMERICA, PETITIONER

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
ET AL., RESPONDENTS

Order

Upon consideration of the motion of James W. Lauderdale, People's Counsel, Public Utilities Commission of the District of Columbia, made in open court, it is this 11th day of December 1944

Ordered: That the said James W. Lauderdale, People's Counsel, Public Utilities Commission of the District of Columbia, be and he is hereby granted leave to enter his appearance in the above-entitled cause for the purposes set forth in paragraph 3 of the Act of Congress approved December 15, 1926 (Public, No. 529, 69th Congress), amending the Act of March 4, 1913 (Public, No. 435, 62d Congress), with leave to file such intervening petitions, motions or pleadings and to present such oral argument as he may deem to be proper.

(S) DAVID A. PINE,
Justice.

We consent:

- (S) FRANCIS M. SHEA,
Francis M. Shea,
Assistant Attorney General,
- (S) EDWARD M. CURRAN,
Edward M. Curran,
United States Attorney,
Attorneys for Petitioner.
- (S) RICHMOND B. KEECH,
Richmond B. Keech,
Corporation Counsel,
- (S) LLOYD B. HARRISON,
Lloyd B. Harrison,
Special Assistant Corporation Counsel,
Attorneys for Respondents.

In the District Court of the United States for the District
of Columbia

Civil No. 26401

UNITED STATES OF AMERICA, PETITIONER

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
ET AL., RESPONDENTS

Notice of Appeal

Notice is hereby given this 23d day of February 1945, that the United States of America hereby appeals to the United States Court of Appeals for the District of Columbia from the judgment of this Court entered on the 29th day of January 1945, in favor of Respondent Public Utilities Commission of the District of Columbia against said United States of America.

(S) FRANCIS M. SHEA,
Francis M. Shea,
Assistant Attorney General,

(S) EDWARD M. CURRAN,
Edward M. Curran,
United States Attorney,

Attorneys for the United States of America.

Of Counsel:

ARNOLD LEVY,
Special Assistant to the Attorney General.

MARVIN C. TAYLOR,
Attorney, Department of Justice.

In the United States Court of Appeals for the District of
Columbia

No. 8995

UNITED STATES OF AMERICA, APPELLANT

vs.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
ET AL., APPELLEES

**Motion to dismiss Appellant's Appeal and Request for
Oral Argument**

Now comes Potomac Electric Power Company, Intervenor, by its attorneys, in the above entitled cause and respectfully moves the Court to dismiss Appellant's appeal because the Appellant (a) is not a person or corporation affected by Order of the Public Utilities Commission of the District of Columbia, (b) has no interest entitling it to prosecute said appeal, or (c) is not entitled to the relief stated in the Petition of Appeal filed in the lower court.

It is respectfully submitted that Appellant's appeal be dismissed and the Order of the United States District Court dismissing Appellant's Petition of Appeal from the Order of the Public Utilities Commission of the District of Columbia be affirmed.

We respectfully request that the Court permit oral argument of the above Motion.

(S) S. R. BOWEN,
S. R. Bowen,

(S) H. W. KELLY,
H. W. Kelly,

(S) WM. K. LAWS,
Wm. K. Laws,

*Attorneys for Potomac Electric Power Co., Intervenor,
929 E Street, NW., Washington, D. C.*

Copy of above Motion and Points and Authorities mailed to
opposing counsel this 10th day of April 1945.

S. R. BOWEN.

In the United States Court of Appeals for the District of
Columbia

No. 8995

UNITED STATES OF AMERICA, APPELLANT

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
ET AL., APPELLEES

*To Francis M. Shea, Esquire, and Marvin C. Taylor, Esquire,
Counsel for the United States.*

We propose to print in the appendix to accompany our Motion to Dismiss the following papers, and which we trust will be acceptable to you so that there may be a joint appendix filed.

1. Petition of Appeal of the United States.
2. Order permitting intervention of People's Counsel and Potomac Electric Power Company.
3. Answer of Public Utilities Commission, and with notation that the answer of People's Counsel is substantially the same.
4. Answer of Potomac Electric Power Company.
5. Order of the District Court dismissing Petition of Appeal.
6. Statement of District Court of reasons for dismissal.
7. Notice of Appeal.
8. Motion to Dismiss.
9. This designation.

We also expect to have printed Section 43-704, 1940 Code, omitting first paragraph, and Section 43-205, 1940 Code.

(S) S. R. BOWEN,

S. R. Bowen,

(S) H. W. KELLY,

H. W. Kelly,

(S) WM. K. LAWS,

Wm. K. Laws,

Attorneys for Potomac Electric Power Co., Intervenor.

Copy of this paper mailed to opposing counsel this 1st day of May 1945.

(S) S. R. BOWEN.

S. R. Bowen.

TO THE HONORABLE MEMBERS OF THE HOUSE OF REPRESENTATIVES

OF THE STATE OF NEW YORK

ALBANY: PUBLISHED BY THE STATE OF NEW YORK, 1880.

AND BY THE STATE OF NEW YORK, 1880.

THE STATE OF NEW YORK, 1880.

THE STATE OF NEW YORK, 1880.

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THE STATE OF NEW YORK, 1880.

**BRIEF FOR MOVING PARTY (APPELLEE) POTOMAC
ELECTRIC POWER COMPANY.**

IN THE
United States Court of Appeals

DISTRICT OF COLUMBIA.

*United States Court of Appeals
for the District of Columbia*

No. 8995

FILED MAY 11 1945

Joseph W. Starns

CLERK

UNITED STATES OF AMERICA, *Appellant,*

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA, ET AL., AND POTOMAC ELECTRIC POWER CO., *Appellees.*

**Motion to Dismiss Appellant's Appeal from the District
Court of the United States for the District of Columbia.**

S. R. BOWEN,

H. W. KELLY,

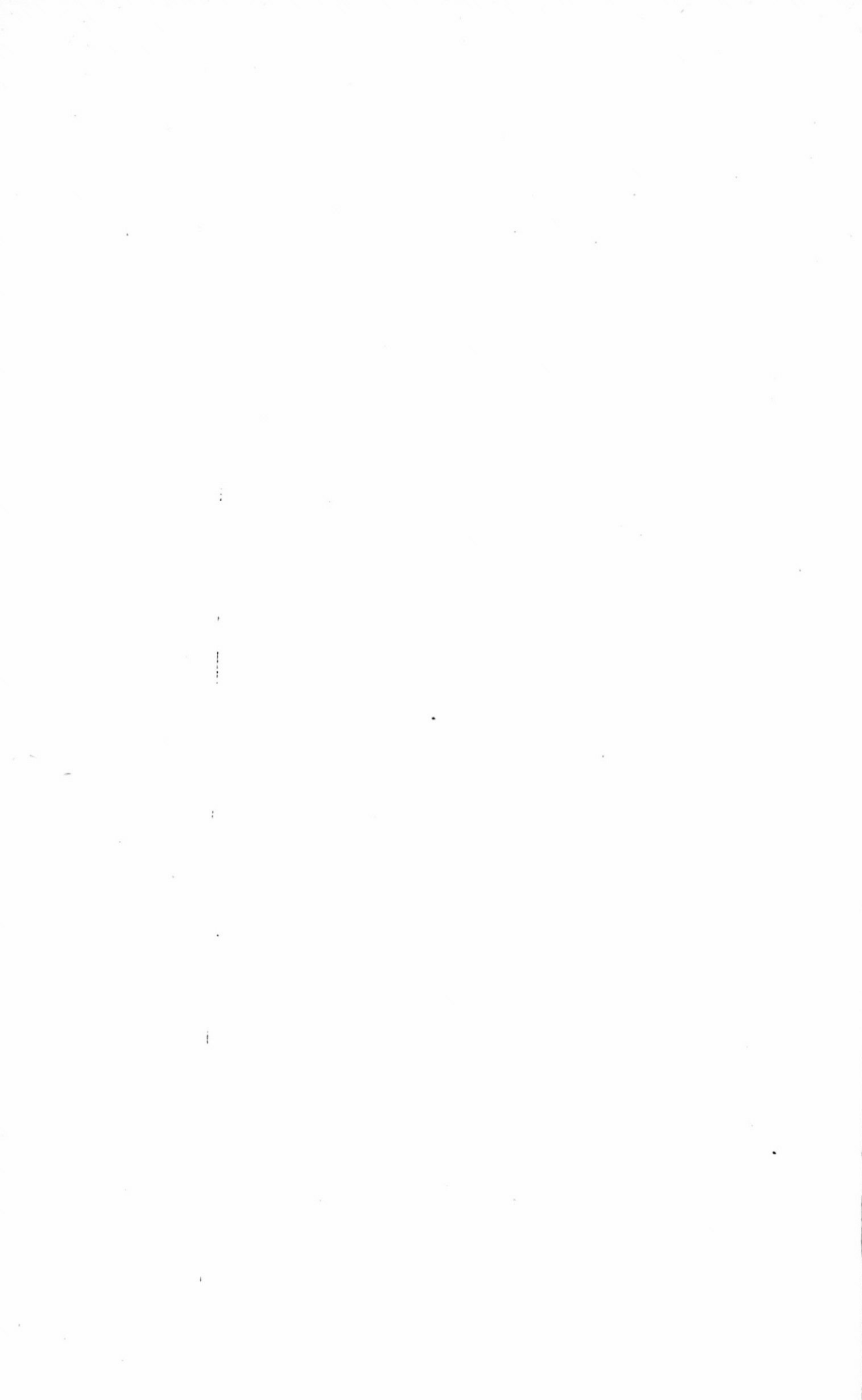
Wm. K. LAWS,

Attorneys for

Potomac Electric Power Company, Intervenor,

929 E Street, N. W.,

Washington 4, D. C.



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the District of Columbia. The jurisdiction of the District Court to review on petitions of appeal the final order of the Commission is provided for by §43-705, D. C. Code (1940) (Page 12 of this brief).

The order of the District Court was entered on January 29, 1945 (App. 221).¹ Notice of appeal was filed on February 23, 1945 (App. 225), and Appellee Potomac Electric Power Company (the "Company") filed its motion to dismiss such appeal (App. 226) on April 10, 1945, pursuant to Rule 31 of the General Rules of this Court.

STATEMENT OF CASE.

On July 22, 1944, the Commission issued its Order No. 2796 establishing rates, tolls and charges of the Company. Thereafter the United States of America, two of whose Agencies had been permitted to intervene in the proceedings before the Commission, filed its Petition of Appeal from said Order in the District Court of the United States for the District of Columbia (App. 47). The Company also appealed from said Order. The United States of America was permitted to intervene in that appeal by the District Court and by its answer asked that the Order of the Commission be sustained.

Orders were entered by the District Court permitting the intervention in said proceedings of People's Counsel and of the Company (App. 224 and 223, respectively). Thereafter answers to said Petition of Appeal were filed by the Commission (App. 209), People's Counsel (App. 217) and the Company (App. 218). Argument was heard in the District Court, and on January 29, 1945, the Court entered an order (App. 221) granting the Company's motion (contained in its answer to said Petition of Appeal) to dismiss said appeal. On January 30, 1945, the Court filed a memorandum setting forth its reasons for such action (App. 222).

On February 28, 1945, the Appellant filed its appeal in this Court (App. 225), asking among other things that the

¹ References to "App." are to the appendix hereto.

Commission's Order No. 2796 be declared erroneous. The Company on April 10, 1945, filed its motion to dismiss such appeal (App. 226).

The Appellant does not allege that it is participating in this proceeding in its governmental capacity and stated in the District Court that its status was solely that of a large consumer of electric energy.

The Appellant has filed a motion to consolidate said appeals, and the Company has opposed such consolidation on the ground that the questions of fact and law in the two appeals are entirely different.

STATUTES INVOLVED.

The principal statutory provisions involved are paragraphs 65 (§43-705, D. C. Code, 1940) and 91A (§43-205, D. C. Code, 1940) of the Act creating the Public Utilities Commission of the District of Columbia² (Pages 12 and 14, respectively of this brief).

STATEMENT OF POINTS.

The lower Court correctly decided that Appellant's Petition of Appeal from Order No. 2796 fails to state any facts showing:

1. That Appellant is a person or corporation affected by Order No. 2796 of the Commission within the meaning of Section 43-705, D. C. Code (1940); or

2. That Appellant has any interest entitling it to prosecute said appeal.

SUMMARY OF ARGUMENT.

1. Permission to intervene in a proceeding conducted by an administrative agency, such as the Commission, does not vest a party with an interest entitling him to file an independent and separate appeal to the Courts.

² Enacted as Section 8 of an appropriation act. Act of March 4, 1913, 37 Stats. 984, as amended December 15, 1926, 44 Stats. 921, and August 27, 1935, 49 Stats. 882.

2. The Appellant as a consumer has no property right or other interest permitting it to maintain an independent appeal from an order of the Commission of general application to consumers; and it is admitted that Appellant does not appear in this proceeding in a governmental capacity. The statute as amended provides for a People's Counsel who shall represent all consumers, including the United States as a consumer.

3. The Statutes of the District of Columbia provide for a People's Counsel to represent and appear for consumers desirous of complaining of matters concerning rates or service of utilities. Subsequent amendment of the provisions of the statutes pertaining to the right of appeal to the Court from a final order of the Commission indicates that the Congress intended People's Counsel alone to have the right of appeal on behalf of consumers from rate orders affecting consumers generally.

The issues are:

Is the Appellant a person or corporation affected by Order No. 2796 of the Commission within the meaning of § 43-705 of the D. C. Code (1940), and does it have any interest entitling it to prosecute an appeal from said Order?

The District Court dismissed the Appellant's Petition of Appeal for the further reason that it failed to state any facts entitling Appellant to relief. This was set forth in support of the Company's motion to dismiss the appeal. However, we have been advised that the Court at this time will consider only points 1 and 2 of the Company's motion. Accordingly, the third point upon which the lower Court also based its opinion and the Company's motion was premised is not discussed herein. It of course is not waived, and we assume that we may argue the same before this Court if the occasion should arise.

ARGUMENT.

The Act creating the Public Utilities Commission of the District of Columbia was approved March 4, 1913.³ Paragraph 64 thereof, as originally enacted, provided:

“That any public utility and any person or corporation interest (ed) being dissatisfied with any order or decision of the commission fixing any valuation, rate or rates, tolls, charges, schedules, joint rate or rates, or regulation, requirement, act, service or other thing complained of may commence a proceeding in equity in the Supreme Court of the District of Columbia against the commission, as defendants, to vacate, set aside, or modify any such decision or order on the ground that the valuation, rate or rates, tolls, charges, schedules, joint rate or rates, or regulation, requirement, act, service, or other thing complained of fixed in such order is unlawful, inadequate, or unreasonable.”

The comparable provisions of the Act, as subsequently amended and now in effect,⁴ are as follows:

“Any public utility, or any other person or corporation affected by any final order or decision of the commission, * * * may, within sixty days after final action by the commission upon the petition for reconsideration, file with the clerk of the District Court of the United States for the District of Columbia, a petition of appeal setting forth the reasons for such appeal and the relief sought; * * *.”

The significant change is that in 1913 the Utility Act permitted an appeal by any person interested who was dissatisfied with an order establishing rates of a utility; whereas the present statutory provision limits the right of appeal to persons “affected by” any such order.

³ *Supra*, footnote 2.

⁴ Par. 65 of the Act approved August 27, 1935, 49 Stats. 882. § 43-705, D. C. Code (1940).

The reason for this Congressional limitation of the group entitled to appeal to the Court from an order of the Commission becomes apparent when it is noted that the Congress, some thirteen years after the date of the original enactment, provided for a People's Counsel to represent the interests of consumers⁵ as follows:

“who—(1) Shall represent and appear for the people of the District of Columbia at all hearings of the commission and in all judicial proceedings involving the interests of users of the products of or service furnished by public utilities under the jurisdiction of the commission; (2) shall represent and appear for petitioners appearing before the commission for the purpose of complaining in matters of rates or service; and (3) may investigate the service given by, the rates charged by, and the valuation of the properties of, the public utilities under the jurisdiction of the commission.”

A consumer under the usual statutory provisions such as those above quoted does not have any property right or other interest permitting it to file an independent appeal and Appellant's status here is that of a consumer alone. The Appellant does not set forth in its Petition of Appeal to the lower Court any facts differentiating the character of its interest from that of consumers generally. In this respect Appellant is in the same position as was the City of New York in the case of *City of New York v. New York Telephone Co.*, 261 U. S. 312, 67 L. ed. 673. The Court there held that the city could not participate in a proceeding which sought to enjoin a rate order entered by the regulatory body. See also *Moffat Tunnel League v. U. S.*, 289 U. S. 113, 77 L. ed. 1069; *In re Englehard & Sons*, 231 U. S. 646, 58 L. ed. 416; *Radford Iron Co. v. Appalachian Electric Power Co.*, 62 F. (2d) 940, cert. denied 289 U. S. 748, 77 L. ed. 1494; *City of New York v. Consolidated Gas Co. of New York*, 253 U. S. 219, 64 L. ed. 870; and *Edward Hines Yellow Pine, Trustees*, 263 U. S. 143, 68 L. ed. 217.

⁵ Act of December 15, 1926, 44 Stats. 921, § 43-205, D. C. Code (1940).

In the recent case of *Associated Industries v. Ickes*, 134 F. (2d) 694, the Court in passing upon a right of intervention by consumers in suits attacking state commission rate orders, said that they are unlike the usual case, adding:

“For instance, in *City of New York v. New York Tel. Co.*, 261 U. S. 312, 316, 43 S. Ct. 372, 67 L. ed. 673, a state commission had made orders reducing telephone rates in the New York City area and the telephone company brought suit to enjoin those orders, making the commission and the State Attorney General parties defendant. The City moved to be made a party defendant in those suits, in order to assist in defending the commission’s orders; the trial court denied the motion. * * *.”

In the *Associated Industries* case the Court in discussing the question of intervention pointed out that cases like the *New York Telephone Co.*, *supra*, were not to be confused with the ordinary case brought for intervention. The statements of the Court with reference to intervention would apply with at least equal force to a separate independent appeal such as the present one. In other words, where the only interest of one is in the rate he or it enjoys for electricity used, this is insufficient to create a justiciable controversy. The interest must be a proprietary interest, possessed, protected or invaded—which is not the case here. See *Alexander Sprunt & Son v. U. S.*, 281 U. S. 249, 74 L. ed. 832. In order for the United States to maintain its separate and independent appeal it would have to show a legal right or interest differing from that of consumers generally. Here the situation or interest of the United States is identical to that of the other consumers of the Company.

In *Alabama Power Company v. Ickes*, 302 U. S. 463, 82 L. ed. 375, a bill had been brought in the United States District Court for the District of Columbia to restrain a loan and grant by the Federal Administrator of Public Works, on the ground that appellant would suffer loss as a result

thereof. The District Court held plaintiff had standing to challenge the Administrator's action but denied the injunction. This Court on appeal held that it was unnecessary to consider the case upon its substantive merits and affirmed on the ground that no legal or equitable right had been invaded. In its affirmance, the Supreme Court fully discussed the nature of interests that may and may not give rise to legally enforceable rights and pointed out that the only injury of which one can be heard to complain in a judicial tribunal is the invasion of some legal or equitable right.

The Court also pointed out that the case of *Chicago Junction (B. & O. Railroad v. U. S.)*, 264 U. S. 258, 68 L. ed. 667) was not to the contrary. We lay stress upon this because of the fact that the Appellant here particularly relied upon the *Chicago Junction* case in the District Court. The *Chicago Junction* suit was brought by certain railroad companies to set aside an order of the Interstate Commerce Commission authorizing a competing company to acquire a terminal railroad. Answering the contention that the complainants were without the legal interests necessary to entitle them to challenge the order, the Supreme Court held that the right to sue in the above suit arose by virtue of special interests recognized by certain specific provisions of the Transportation Act. In any event, it is abundantly clear from the *Alabama Power* case that the *Chicago Junction* case rests upon the peculiar provisions of the particular statute governing that controversy. Appellant's position is also unlike that of the plaintiff in the case of *U. S. v. Hubbard*, 266 U. S. 471, 69 L. ed. 389.

The case of *U. S. ex rel American Silver Producers Association v. Mellon, Secretary of the Treasury*, 59 App. D. C. 24, involved the right of appellants to bring a suit to compel the Secretary of the Treasury to make purchases of silver under the Pittman Act. The Court pointed out that persons without legal interests in the subject matter were not entitled to a writ of mandamus and that they must have

a personal and direct interest in the subject matter of litigation rather than merely an indirect or remote interest, citing *Edward Hines Yellow Pine, Trustees, supra*. See also *U. S. ex rel Alsop Process Company v. Wilson*, 33 App. D. C. 472, which involved the right of appellant to challenge an order of the Secretary of Agriculture to the effect that flour bleached by nitrogen peroxide is an adulterated product under the Food and Drug Act. This Court held that the relator had no such interest as to entitle it to institute the proceeding, pointing out that a complainant must show direct and material damages citing cases.

In *City of Chicago v. Chicago Rapid Transit Company*, 284 U. S. 577, 76 L. ed. 501, the City of Chicago had been permitted to intervene as a defendant in a suit brought to restrain the public service commission and attorney general of the State of Illinois from enforcing a rate order. The Court held, however, that it had no separate standing which entitled it to appeal from the lower Court's decrees, citing *Pawhuska v. Pawhuska Oil and Gas Company*, 250 U. S. 394, 63 L. ed. 1054; *Chicago v. Dempsey*, 250 U. S. 651, 63 L. ed. 1189; *Denny v. Pacific Telephone and Telegraph Company*, 276 U. S. 97, 72 L. ed. 483; *Railroad Commission v. Los Angeles R. Corporation*, 280 U. S. 145, 74 L. ed. 234; *Chicago R. Company v. Chicago*, 257 U. S. 617, 66 L. ed. 399; and also *New York v. New York Telephone Company*, 261 U. S. 312, 67 L. ed. 673, previously cited by us.

In *Boston Towboat Company v. U. S.*, 321 U. S. 632, 88 L. ed. 975, the Court held that an intervenor in an action brought to set aside an order of the Interstate Commerce Commission, whose only interest was in the effect of the decision therein as a precedent in similar litigation directly affecting it, had no "independent right" entitling it to appeal. The Court, among other things, stated that it was not called upon to determine whether the appellant had sufficient interest to have been properly permitted to intervene before the Commission and the District Court, the only issue being whether it had an "independent right"

which had been violated, and added clearly it has not, citing numerous cases, among them being *Alexander Sprunt & Sons v. U. S.*, and *Edward Hines Yellow Pine, Trustees v. U. S.*, *supra*.

In the *Sprunt* case, which was also relied upon by the Appellant in the lower Court, the United States Supreme Court held that the appellants' competitive interest entitled them to intervene in the administrative proceeding but did not give them the right to maintain an independent suit to set aside the commission's order. Such a suit can be brought by a shipper only where a right of his own is alleged to have been affected by the order, and his independent right to relief is no greater by reason of his having become a party to the proceeding whether by intervention or otherwise. In the case at bar the Appellants have no independent right which is violated by the order. The competitive advantage the appellants enjoyed was merely an instance of the right, if any, of the carriers to maintain the particular tariff in force and their continuing desire to do so.

In the *Yellow Pine* case a suit had been brought to set aside an order of the Interstate Commerce Commission. The United States moved to dismiss on the ground that the plaintiffs had not shown such an interest in the subject matter as entitled them to sue, and for want of equity. The order of the commission had set aside a penalty charge of ten dollars per day for cars held for reconsignment points, thus adversely affecting the plaintiffs' competitive situation since it had not in the past operated in such a way as to require the payment of such charges. The suit was brought to set aside said order as in excess of the Commission's power. This alone the Court said was insufficient. Plaintiffs must also show that the order alleged to be void subjects them to legal injury, which they failed to do. Plaintiffs' right is limited to protection against unjust discrimination. Redress against discrimination must be sought by proceedings before the Commission. The find-

ings made by the Commission negative any such claim and their correctness cannot be judicially assailed.

See also *L. Singer & Sons v. Union Pac. R. Co.*, 109 F. (2d) 493, and affirmed in 311 U. S. 295, 85 L. ed. 198.

The Appellant, having intervened in the Company's appeal from the Commission's Order 2796, is limited to the field of litigation open to the original parties. *Columbia Gas and Electric Corporation v. American Fuel and Peat Company*, 322 U. S. 375, 88 L. ed. 1337, citing with approval *Vinson v. Washington Gas Light Company*, 321 U. S. 489, 88 L. ed. 883.

CONCLUSION.

The motion to dismiss should be sustained and the judgment of the District Court dismissing the Appellant's appeal from Order 2796 of the Public Utilities Commission of the District of Columbia should be affirmed.

Respectfully submitted,

S. R. BOWEN,

H. W. KELLY,

Wm. K. LAWS,

Attorneys for

Potomac Electric Power Company, Intervenor,

929 E Street, N. W.,

Washington 4, D. C.

APPENDIX OF STATUTES INVOLVED.**Excerpts from District of Columbia Code 1940.****SECTION 43-704:**

* * * *

That any public utility or any other person or corporation affected by any final order or decision of the commission may, within thirty days after the publication thereof, file with the commission an application in writing requesting a reconsideration of the matters involved, and stating specifically the errors claimed as grounds for such reconsideration. No public utility, or other person or corporation shall in any court urge or rely on any ground not so set forth in said application. The commission, within thirty days after the filing of such application, shall either grant or deny it. Failure by the commission to act upon such application within such period shall be deemed a denial thereof. If such application be granted, the commission, after giving notice thereof to all interested parties, shall, either with or without hearing, rescind, modify, or affirm its order or decision. The filing of such an application shall act as a stay upon the execution of the order or decision of the commission until the final action of the commission upon the application: *Provided*, That upon written consent of the utility such order or decision shall not be stayed unless otherwise ordered by the commission. No appeal shall lie from any order of the commission unless an application for reconsideration shall have been first made and determined.

SECTION 43-705:

The District Court of the United States for the District of Columbia shall have jurisdiction to hear and determine any appeal from an order or decision of the commission. Any public utility, or any other person or corporation affected by any final order or decision of the commission, other than an order fixing or determining the value of the property of a public utility in a proceeding solely for that purpose, may, within sixty days after final action by the commission upon the petition for reconsideration, file with the clerk of the District Court of the United States for the District of Columbia, a petition of appeal setting forth

the reasons for such appeal and the relief sought; at the same time such appellant shall file with the commission notice in writing of the appeal together with a copy of the petition. Within twenty days of the receipt of such notice of appeal the commission shall file with the clerk of the said court the record, including a transcript of all proceedings had and testimony taken before the commission, duly certified, upon which the said order or decision of the commission was based, together with a statement of its findings of fact and conclusions upon the said record, and a copy of the application for reconsideration and the orders entered thereon: *Provided*, That the parties, with the consent and approval of the commission, may stipulate in writing that only certain portions of the record be transcribed and transmitted. Within this period the commission or any other interested party shall answer, demur, or otherwise move or plead. Thereupon the appeal shall be at issue and ready for hearing. All such proceedings shall have precedence over any civil cause of a different nature pending in said court, and the District Court of the United States for the District of Columbia, shall always be deemed open for the hearing thereof. Any such appeal shall be heard upon the record before the commission, and no new or additional evidence shall be received by the said court. The said court, or any justice or justices thereof, before whom any such appeal shall be heard, may require and direct the commission to receive additional evidence upon any subject related to the issues on said appeal concerning which evidence was improperly excluded in the hearing before the commission or upon which the record may contain no substantial evidence. Upon the receipt of such requirement and direction the commission shall receive such evidence and without unreasonable delay shall transmit to the said court the findings of fact made thereon by the commission and the conclusions of the commission upon the said facts.

Upon the conclusion of its hearing of any such appeal the court shall either dismiss the said appeal and affirm the order or decision of the commission or sustain the appeal and vacate the commission's order or decision. In either event the court shall accompany its order by a statement of its reasons for its action, and in the case of the vacation of an order or decision of the commission the

statement shall relate the particulars in and the extent to which such order or decision was defective.

Any party, including said commission, may appeal from the order or decree of said court to the United States Court of Appeals for the District of Columbia, which shall thereupon have and take jurisdiction in every such appeal. Thereafter the Supreme Court of the United States may, upon a petition for certiorari granted in its discretion, review the said case. * * *

SECTION 43-205:

There shall be appointed by the President, by and with the advice and consent of the Senate, an additional counsel of the commission to be known as the people's counsel, who—(1) Shall represent and appear for the people of the District of Columbia at all hearings of the commission and in all judicial proceedings involving the interests of users of the products of or service furnished by public utilities under the jurisdiction of the commission; (2) shall represent and appear for petitioners appearing before the commission for the purpose of complaining in matters of rates or service; and (3) may investigate the service given by, the rates charged by, and the valuation of the properties of, the public utilities under the jurisdiction of the commission. (b) The term of office of the people's counsel shall be four years, and he shall receive a salary at the rate of \$7,500 a year. No person shall be appointed as people's counsel who has not been a bona fide resident of the District of Columbia continuously for a period of at least five years immediately preceding the effective date of his appointment, or who has not been engaged in the actual practice of law before the District Court of the United States for the District of Columbia for a period of at least five years. No person shall be eligible to the office of people's counsel who is, or who shall have been during a period of five years next preceding his appointment, directly or indirectly interested in any public utility operating, owning, or having an interest in property in the District of Columbia, or in any stock, bond, mortgage, security or contract of any such public utility.

No. 8995

United States Court of Appeals

DISTRICT OF COLUMBIA

UNITED STATES OF AMERICA, APPELLANT

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
AND JAMES H. FLANAGAN, JAMES F. REILLY AND CHARLES W.
KUTZ, CONSTITUTING THE PUBLIC UTILITIES COMMISSION
OF THE DISTRICT OF COLUMBIA, RESPONDENTS; AND JAMES
LAUDERDALE, PEOPLE'S COUNSEL; AND POTOMAC ELECTRIC
POWER COMPANY, INTERVENORS

APPEAL FROM JUDGMENT OF THE UNITED STATES DISTRICT
COURT FOR THE DISTRICT OF COLUMBIA

BRIEF FOR APPELLANT IN OPPOSITION TO MOTION TO DISMISS APPEAL

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*United States Court of Appeals
for the District of Columbia*

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CLERK

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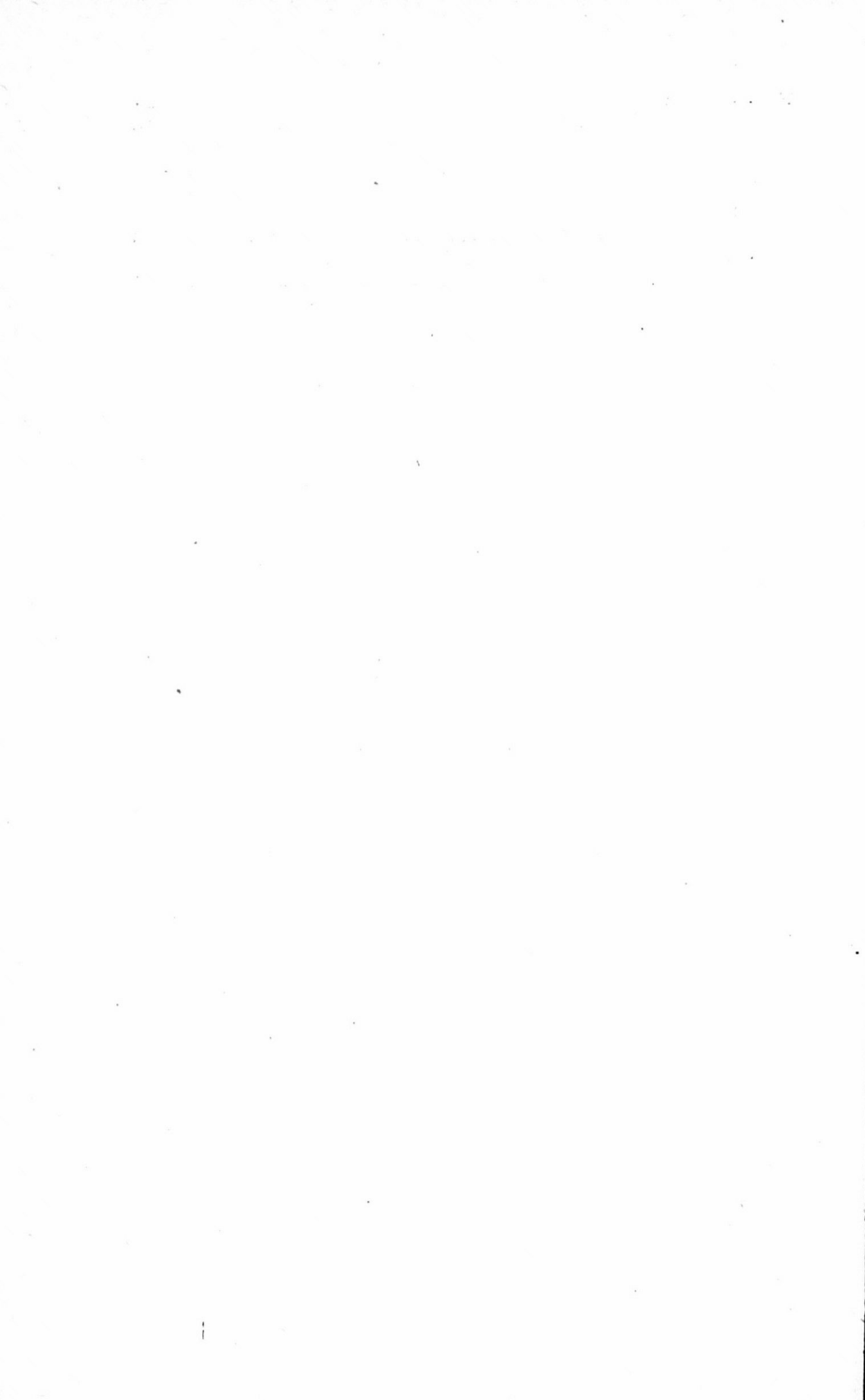
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United States Court of Appeals

DISTRICT OF COLUMBIA

No. 8995

UNITED STATES OF AMERICA, APPELLANT

v.

PUBLIC UTILITIES COMMISSION OF THE DISTRICT OF COLUMBIA,
AND JAMES H. FLANAGAN, JAMES F. REILLY AND CHARLES W.
KUTZ, CONSTITUTING THE PUBLIC UTILITIES COMMISSION
OF THE DISTRICT OF COLUMBIA, RESPONDENTS; AND JAMES
LAUDERDALE, PEOPLE'S COUNSEL; AND POTOMAC ELECTRIC
POWER COMPANY, INTERVENORS

*APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE
DISTRICT OF COLUMBIA*

BRIEF FOR APPELLANT IN OPPOSITION TO MOTION TO DISMISS APPEAL

STATEMENT

Potomac Electric Power Company (herein called PEPCO) is a District of Columbia corporation engaged in generating and selling electric energy in the District of Columbia. It is a "public utility" as defined in Title 43 of the District of Columbia Code (1940) (herein referred to as the Code). The appellant is PEPCO's largest customer, paying approximately \$6,000,000 a year for electric energy. The Public Utilities Commission of the District of Columbia (herein called the Commission) was created by Act of March 4, 1913 (37 Stat. 974), sec. 8, par. 1-103 (herein called the Utility Law); with

the powers and duties set forth in this statute and subsequent amendments thereof.¹ James H. Flanagan, James F. Reilly, and Charles W. Kutz are presently the members of the Commission.

James W. Lauderdale is the present "People's Counsel" appointed pursuant to par. 91A of the Utility Law (Code, 43-205). At the time of the proceedings before the Commission giving rise to this appeal the office of People's Counsel was vacant. Mr. Lauderdale was appointed pending the proceedings but did not qualify till after they were closed, and took no part in them, and did not file an "application for reconsideration" with the Commission, which is a condition precedent to his right to prosecute an appeal from the proceedings and order (Utility Law, par. 64; Code, 43-704).

Since January 1, 1925, the Commission has purported to fix the rates to be charged by PEPCO according to a so-called "sliding scale agreement" (App., pp. 49, 51, 52) which was first established by a "consent decree" of the District Court entered in District Court Equity Cases Nos. 35336 and 35341 (Copy appears at App., pp. 57 to 64). The sliding-scale arrangement established \$32,500,000 as the rate base to be used in calculating rates, 7½ percent as a fair return thereon, contained provisions for the accrual of a depreciation reserve and fixed 4 percent as the rate at which interest should be accrued to the reserve (regardless of actual earnings), and contained provisions for rate adjustments downward or upward when the actual earnings were above or below 7½ percent of the rate base.

Actual earnings for the years 1925-1942 inclusive—notwithstanding several changes in the basic rate of return which reduced it from 7½ percent to 6 percent—exceeded the basic return by amounts averaging annually 60.97 percent of the par value of PEPCO's outstanding common stock and 161.25 percent of the amount actually invested in common stock. Dividends paid in these years average 38.49 percent per year on

¹ The District of Columbia Code (1940) groups all statutes, including the Public Utility Law, in "Title 43—Public Utilities." For the convenience of the Court, statutory references herein will be to both the Utility Law and the Code.

the outstanding common and 101.33 percent per year on the amount actually invested in common stock (App., pp. 51, 64, 65).

At the annual rate hearing held by the Commission in 1943, the United States of America was permitted to intervene. It urged reexamination and amendment or abandonment of the sliding scale arrangement on the ground that its operation had not resulted and could not result in rates which are just and reasonable. The Commission limited its consideration to the fixing of rates under the sliding scale arrangement; and by its Order No. 2564 of April 26, 1943, fixed rates for that year. The net earnings under that order were again greatly in excess of the amount computed on the rate base at the prescribed rate of return. The net income for 1943 available for common stock dividends was \$3,786,418; which amounted to 42.07 percent on all the common stock outstanding, or 72.19 percent on the amount of money actually invested in common stock. The company paid out \$3,150,000 in dividends; which amount to 35.00 percent of the entire outstanding common, or 60.00 percent on the amount actually invested in common stock (App., p. 51).

On April 26, 1943, by its Order No. 2565, the Commission ordered an investigation to determine whether the sliding scale arrangement should be retained, basically modified as to the rate base, the rate of return, depreciation accruals and the method of effecting rate adjustments, or abandoned. On January 5, 1944, the Commission, by its Order No. 2703, directed an investigation of rates under the sliding scale arrangement as it existed or as it might be modified. By the Notice of Hearing issued on January 26, 1944 the matters set forth in Orders Nos. 2565 and 2703 were consolidated for formal public hearing (App., p. 2).

The United States, through its agencies, Treasury Department by its Director of Procurement and the Public Buildings Administration, applied for and was granted leave to intervene in the case, thereby acquiring standing as a "party" under the rules of the Commission. (See rules printed *infra*, p. 11). The United States participated in the hearings throughout, filed briefs and argued orally, and filed applications for recon-

sideration, as required by Utility Law, par. 64, Code, sec. 43-704, which were denied.

On July 22, 1944, the Commission issued its "Findings and Opinion and Order No. 2796," which is the order involved in this appeal. The order required PEPCO to file a new rate schedule "*which, when applied to kwh. consumption during the test year 1943 will reduce its gross operating revenues by * * * \$1,037,000*" [italics supplied] (App., p. 45). It adopted a depreciated original cost rate base in place of the base arrived at by application of the terms of the consent decree. It adopted a rule for depreciation accruals different from that provided in the consent decree. It reduced the basic rate of return from 6 percent to $5\frac{1}{2}$ percent. In the calculation which resulted in the order for a reduction of \$1,037,000, the Commission allowed PEPCO to earn \$257,214.77 on top of $5\frac{1}{2}$ percent of the rate base (App., pp. 42, 43).

PEPCO appealed to the District Court (Civil Action 25477) on the grounds (a) that the changes in the sliding scale arrangement were so sweeping as to be beyond the power of the Commission in the absence of assent of PEPCO, which it refused to give; (b) that the order must rest therefore on the general statutory authority of the Commission and that it is in excess of that authority because the rate base was not based on replacement value (which PEPCO claims is required by the Code) and (c) that the reduction is so large as to be unreasonable and confiscatory. The United States and the People's Counsel were permitted, on motions filed in Civil Action 25477, to intervene in that appeal.

The United States also appealed to the District Court (Civil Action 26401) on the grounds that substantial errors of law had been committed by the Commission (a) in ruling that it is without power to even consider the desirability of the exclusion from the rate base of any part of PEPCO's \$29,000,000 surplus which has built up out of the excessive earnings described above (App., p. 53, 54), (b) in insisting that it must as a matter of law include all of the surplus in the common stock equity in computing the cost of capital component of the permitted basic rate of return, (c) in ruling that exclusion of all or some part of the surplus from the rate base and from

the common stock equity is not required by par. 75 of the Utility Law (Code, 43-804), (d) in ruling that PEPCO is entitled to a return on that part of its outstanding stock for which no consideration was paid to the company, (e) in ruling that par. 16 of the Utility Law (Code, 43-315) does not require the addition to the depreciation reserve of PEPCO's actual earnings on the reserve but only of the 4 percent accruals provided for in the consent decree, (f) in excluding Exhibit 74, which shows that control of PEPCO was illegally acquired and held—which circumstance has a substantial bearing on the question of the propriety of capitalizing the surplus, (g) in fixing the reduction at too small a figure, which will result of necessity in rates which are unjustly and unreasonably high. PEPCO and the People's Counsel were permitted to intervene, on motion, in Civil Action 26401.

The two petitions of appeal were consolidated for hearing in the District Court. Upon conclusion of the arguments, the court below dismissed PEPCO's complaint on the merits. It dismissed the appeal of the United States with the following "Statement of Reasons for Decision":

Because said Petition fails to state any facts (a) showing that Petitioner is a person or corporation affected by Order No. 2796 of the Public Utilities Commission of the District of Columbia from which it has filed said appeal, within the meaning of the Act of Congress approved March 4, 1913, as amended (Sec. 43-705, D. C. Code); (b) showing that the Petitioner has any interest entitling it to prosecute said appeal, or (c) entitling the Petitioner to relief herein.

Moreover the United States does not have any property right or such interest to file independent appeal where its only basis is that of a consumer of the Potomac Electric Power Company, and the Court feels strengthened in this view by the amendatory provision in the Act creating the said Commission providing for a People's Counsel and prescribing his duties in respect thereto. (App., p. 222.)

It is asserted by PEPCO and the Commission that the order of the District Court dismissing the petition of Appeal was not based solely on the ground that the United States has no standing to prosecute such a petition, but also on the ground that the petition of appeal is demurrable. We shall discuss this matter in detail in the fourth section of the argument dealing with the question of the form of order to be entered, and the nature of the further proceedings in this Court, if the pending motion to dismiss is denied.

JURISDICTION

Jurisdiction of this appeal is based on paragraph 65 (Code, sec. 43-705) reading:

Any party, including said commission, may appeal from the order or decree of said court to the Court of Appeals of the District of Columbia, which shall thereupon have and take jurisdiction in every such appeal. * * *

STATUTES INVOLVED

The sections of the Utility Law (Act of March 4, 1913 (37 Stat. 974), sec. 8, par. 1-103) which are principally involved are as follows. The references to the District of Columbia Code (1940) are stated in each instance.

Utility Law, paragraph 2; Code, section 43-301:

That every public utility doing business within the District of Columbia is required to furnish service and facilities reasonably safe and adequate and in all respects just and reasonable. The charge made by any such public utility for any facility or services furnished, or rendered, or to be furnished or rendered, shall be reasonable, just and nondiscriminatory. Every unjust or unreasonable or discriminatory charge for such facility or service is prohibited and is hereby declared unlawful. Every public utility is hereby required to obey the lawful orders of the commission created by this section.

Utility Law, paragraph 18; Code, section 43-317:

That nothing in this section shall be taken to prohibit a public utility, with the consent of the commission, from providing a sliding scale of rates and dividends according to what is commonly known as the Boston sliding scale, or other financial device that may be practicable and advantageous to the parties interested. No such arrangement or device shall be lawful until it shall be found by the commission, after investigation, to be reasonable and just and not inconsistent with the purposes of this section. Such arrangement shall be under the supervision and regulation of the commission. The commission shall ascertain, determine, and order such rates, charges, and regulations, and the duration thereof, as may be necessary to give effect to such arrangement, but the right and power to make such other and further changes in rates, charges, and regulations as the commission may ascertain and determine to be necessary and reasonable, and the right to alter or amend all orders relative thereto, is reserved and vested in the commission notwithstanding any such arrangement and mutual agreement.

Utility Law, paragraph 64; Code, section 43-704:

* * * * *

That any public utility or any other person or corporation affected by any final order or decision of the commission may, within thirty days after the publication thereof, file with the commission an application in writing requesting a reconsideration of the matters involved, and stating specifically the errors claimed as grounds for such reconsideration. No public utility or other person or corporation shall in any court urge or rely on any ground not so set forth in said application. The commission, within thirty days after the filing of such application, shall either grant or deny it. Failure by the commission to act upon such application within such period shall be deemed a denial thereof. If such application be granted, the commission, after giving

notice thereof to all interested parties, shall, either with or without hearing, rescind, modify, or affirm its order or decision. The filing of such an application shall act as a stay upon the execution of the order or decision of the commission until the final action of the commission upon the application: *Provided*, That upon written consent of the utility such order or decision shall not be stayed unless otherwise ordered by the commission. No appeal shall lie from any order of the commission unless an application for reconsideration shall have been first made and determined.

Utility Law, paragraph 65; Code, section 43-705:

The District Court of the United States for the District of Columbia shall have jurisdiction to hear and determine any appeal from an order or decision of the commission. Any public utility, or any other person or corporation affected by any final order or decision of the commission, other than an order fixing or determining the value of the property of a public utility in a proceeding solely for that purpose, may, within sixty days after final action by the commission upon the petition for reconsideration, file with the clerk of the District Court of the United States for the District of Columbia, a petition of appeal setting forth the reasons for such appeal and the relief sought; at the same time such appellant shall file with the commission notice in writing of the appeal together with a copy of the petition. Within twenty days of the receipt of such notice of appeal the commission shall file with the clerk of the said court the record, including a transcript of all proceedings had and testimony taken before the commission, duly certified, upon which the said order or decision of the commission was based, together with a statement of its findings of fact and conclusions upon the said record, and a copy of the application for reconsideration and the orders entered thereon: *Provided*, That the parties, with the consent and approval of the commission, may stipulate in writing that only certain

portions of the record be transcribed and transmitted. Within this period the commission or any other interested party shall answer, demur, or otherwise move or plead. Thereupon the appeal shall be at issue and ready for hearing. All such proceedings shall have precedence over any civil cause of a different nature pending in said court, and the District Court of the United States for the District of Columbia, shall always be deemed open for the hearing thereof. Any such appeal shall be heard upon the record before the commission, and no new or additional evidence shall be received by the said court. The said court, or any justice or justices thereof, before whom any such appeal shall be heard, may require and direct the commission to receive additional evidence upon any subject related to the issues on said appeal concerning which evidence was improperly excluded in the hearing before the commission or upon which the record may contain no substantial evidence. Upon receipt of such requirement and direction the commission shall receive such evidence and without unreasonable delay shall transmit to the said court the findings of fact made thereon by the commission and the conclusions of the commission upon the said facts.

Upon the conclusion of its hearing of any such appeal the court shall either dismiss the said appeal and affirm the order or decision of the commission or sustain the appeal and vacate the commission's order or decision. In either event the court shall accompany its order by a statement of its reasons for its action, and in the case of the vacation of an order or decision of the commission the statement shall relate the particulars in and the extent to which such order or decision was defective.

Any party, including said commission, may appeal from the order or decree of said court to the Court of Appeals of the District of Columbia, which shall thereupon have and take jurisdiction in every such appeal. Thereafter the Supreme Court of the United States may, upon a petition for certiorari granted in its discretion, review the said case.

* * * * *

Utility Law, paragraph 66; Code, section 43-706:

In the determination of any appeal from an order or decision of the commission the review by the court shall be limited to questions of law, including constitutional questions; and the findings of fact by the commission shall be conclusive unless it shall appear that such findings of the commission are unreasonable, arbitrary or capricious.

Utility Law, paragraph 69a; Code, section 43-710:

The method of review of the orders and decisions of the commission provided by paragraphs 64, 65, 66, 67, 68, and 69, herein, shall be exclusive.

Utility Law, paragraph 75; Code, section 43-804:

That no public utility shall declare any stock, bond, or scrip dividend or divide the proceeds of the sale of any stock, bond, or scrip among its stockholders.

Utility Law, paragraph 91A; Code, section 43-205:

* * * There shall be appointed by the President, by and with the advice and consent of the Senate, in lieu of the attorney at law provided for the Public Utilities Commission in the District of Columbia Appropriation Act, approved May 10, 1926, an additional counsel of the commission to be known as the people's counsel, who—(1) Shall represent and appear for the people of the District of Columbia at all hearings of the commission and in all judicial proceedings involving the interests of users of the products of or service furnished by public utilities under the jurisdiction of the commission; (2) shall represent and appear for petitioners appearing before the commission for the purpose of complaining in matters of rates or service; and (3) may investigate the service given by, the rates charged by, and the valuation of the properties of, the public utilities under the jurisdiction of the commission. * * *

The following sections from the "Rules of Practices and Procedure" of the Commission are involved:

RULE 1.1. *Person*.—The term “person” includes an individual, copartnership, association, corporation, body politic, municipal organization, governmental body, joint stock company, receiver, trustee, or official acting in his official capacity.

RULE 1.2. *Party*.—The term “party” means any person who is a complainant, petitioner, respondent, or intervenor in a proceeding.

RULE 7.1. *Petition*.—Any person not named as a party in a proceeding but having a substantial interest therein may petition the Commission for leave to intervene. The petition shall state the petitioner’s interest and otherwise shall conform to Rules 5.1 and 5.2 as to form and number, Rule 5.3 as to contents, Rule 5.9 as to amendments, Rule 5.10 as to further and better statement, and Rule 5.13 as to service. The petition shall be filed and served not less than five days prior to the date fixed for the formal hearing in the proceeding, unless otherwise ordered by the Commission.

SUMMARY OF ARGUMENT

The language of the sections specifically concerned with the right of appeal to the District Court is clearly broad enough to embrace consumers who are complaining of a rate order; and many other sections of the Utility Law clearly imply the existence of such a right. The natural meaning of the words “other persons affected”—when descriptive of others than the utility, as is the case here—surely embraces the customers who must pay the rates. We can think of no other class of whom the words would be descriptive. Congress has power to give a right of appeal to rate payers, and there is no reason for attributing to it a purpose that while the Commission cannot bind the utility by too low rates, it may bind the customers irrevocably by too high rates. There is no reason for distinguishing between the United States as a consumer and other consumers.

The construction urged by PEPCO, which would construe the section of the statute creating the office of People’s Counsel and providing that he “shall represent and appear for” the people of the District of Columbia in all judicial proceedings as

vesting in him the exclusive right to prosecute consumer appeals, would also exclude them from any right to participate personally or through counsel of their own selection in the proceedings before the Commission, since the same section provides in precisely the same form of language that he "shall represent and appear" for the people in those proceedings. The construction is unsound since it would negate the intendment and clearly expressed purposes of many other provisions of the statute, and is contrary to the long settled practice of the Commission and the express provisions of its rules.

The legislative history of the statute as a whole, and also that relating to the creation of the office of People's Counsel, makes clear that the language relied on by PEPCO was inserted only as a definition of the duties of People's Counsel, and to lighten the burden on the legal staff of the Commission, and to make sure that customers (who ordinarily have neither a sufficient stake involved nor enough money to engage in protracted litigation with utility lawyers) should have at least one champion. There are no words of exclusivity in the section; and if they should be read into it they would be in derogation of the natural right to select one's own attorney, would make the section hopelessly irreconcilable with the provisions of the appeal sections and other parts of the act, and would create impossibly difficult situations whenever the interests of particular rate payers were in conflict one with another.

The decisions, in similar situations under similar statutes, clearly support a construction giving the United States standing to appeal.

ARGUMENT

Preliminary comment

The grounds on which an appeal may be dismissed are (a) that the court has no jurisdiction, either because of the nature of the subject matter or because no right of appeal is given to the appellant, (b) that the appeal fails to meet procedural formalities, (c) that the appeal is frivolous, (d) that the questions presented are so well settled that further argument is unnecessary, or (e) that the appeal is prosecuted for purposes

of delay. The merits of a case are not open on a motion to dismiss.²

The record shows clearly that there is no procedural irregularity in this appeal. The statement at page 4, *supra*, of the issues raised by the appeal shows that they are by no means frivolous, but on the contrary are important questions in the field of rate-making law and involve very substantial sums of money. They have not been decided in this District; and they have been touched upon only argumentatively by the Supreme Court. There is no basis for asserting that the United States is seeking delay by proceeding in the District Court or here, since the rates which it claims are unjustly and unreasonably high are still in effect and it is seeking to lower them. The statute (Utility Law, par. 65; Code, sec. 43-705) specifically grants a right of appeal in the District Court. Consequently, the only issue open here, and which we shall discuss, is whether the United States as a customer of PEPCO has standing to institute and prosecute a petition of appeal in the District Court.

I

The language of the code—viewed on its face, apart from legislative history or decisions—requires a conclusion that the right to appeal from rate orders is not available only to public utility companies and people's counsel but may also be exercised by consumers

In this section of the brief we intend to discuss only the significance of the language used by Congress in the controlling statute. We assume that it is too clear to require any discussion that Congress could lawfully give a right of appeal to consumers from rate orders of the Commission. The question is whether the language of the act shows it intended to do so.

The appeal provisions are found in paragraphs 64 and 65 of the Utility Law (Code, secs. 43-704, 43-705), pp. 7, 8,

² *Hill v. C. H. & E. RR. Co.*, 129 U. S. 170, 174-175; *Bohannon v. Nebraska*, 118 U. S. 231, 233; *Lynch v. Dr. Bernall*, 131 U. S. xciv App; *Semple v. Hagar*, 4 Wall. 431, 433, 434; *Amory v. Amory*, 1 Otto 356, 357; and *Atkinson v. United States*, 70 F. (2d) 515.

supra. Paragraph 64 makes the filing with the Commission of an application for reconsideration a condition precedent to the right to prosecute a court appeal. The language used is, "any public utility or other person or corporation affected by any final order or decision of the Commission may" file an application for reconsideration. Paragraph 65 uses precisely the same language in describing the persons entitled to appeal, namely, "Any public utility, or any other person or corporation affected by any final order or decision of the Commission." We can think of no class of persons other than consumers of whom these words would be descriptive.

We emphasize the significance of the use of exactly the same words in describing the class which is admitted to the prosecution of administrative rights and the class which is granted the right of appeal. Since there can be no justification for attributing a different meaning to the words in paragraph 64 from that given to them in paragraph 65, a construction of the words which would grant an appeal to only some limited part of the consumers requires a conclusion that Congress intended to limit to the same special group the right to appear in the administrative proceedings before the Commission. Such a conclusion would be directly in conflict with many provisions of the statute showing a purpose to grant to the users of the services of public utility companies the broadest rights to present and prosecute complaints before the Commission and would also be contrary to the long established administrative practice under the Utility Law. If we are not prepared to thus limit the group entitled to administrative remedies, we cannot escape accepting a construction of the words giving a co-extensive right of appeal.

It is provided further on in paragraph 65 that within a stated period after the entry of a petition of appeal in the District Court "the commission or any other interested party shall answer, demur, or otherwise move or plead." The section further provides that "any party" to the District Court proceedings may appeal to this court. We shall discuss below the significance to be attached to the fact that the United States was admitted as a "party" in the proceedings before the Commission. We call attention to the quoted words at this point

merely because they so clearly indicate that participation in court proceedings is not limited to the Commission and the utility, and may include all other "interested parties,"³ to wit, consumers in rate cases.

Support for this position is found in other parts of the Utility Law. Paragraphs 38 to 42 (Code, secs. 43-408 to 43-412) provide for the making of complaints with respect to rates. These sections do not relate to complaints made by the utility that rates are too low, since such complaints are specifically provided for in paragraphs 47 and 94 (Code, secs. 43-401, 43-417). Paragraphs 49 and 50 (Code, secs. 43-419 to 43-420) provide for the summoning of witnesses at the request of, and the taking of depositions on behalf of, complainants—implying their right to participate before the Commission. Paragraph 42 provides for appeals from the orders made after a hearing initiated by a "complaint." It is implicit in all these provisions that the complainant should have a right to participate in the proceedings before the Commission and to prosecute an appeal; and we can think of no one whom Congress could have had in mind as complainants about rates other than consumers.

Further support for the right of consumers to appeal is found in the provision in paragraph 67 (Code, sec. 43-707) for a stay of a Commission order whenever "substantial and irreparable property loss would be occasioned to the petitioner by the operation of" a rate order. The language is not limited to cases where rates are reduced, and the utility would not be harmed by an order increasing rates. The intendment of the word "petitioner" therefore embraces rate payers who are appealing from unjustly high rates.

³ It is suggested that the use of the words "interested" and "affected" as apparently synonymous or interchangeable is not without significance. The same thing occurs elsewhere in the Utility Law. In paragraph 3 (Code 43-302) it is provided that any "interested person" may initiate proceedings before the Commission to enforce joint use of utility facilities by two utilities when in the public interest. Paragraph 46 (Code 43-416) requires the Commission, before proceeding with a formal hearing as to rates, to give notice to "interested persons." Paragraph 64 (Code 43-704) requires the Commission, if it grants an application for reconsideration of an order, to give notice to "all interested parties" before changing the order.

And in paragraph 63 (Code, sec. 43-703) it is provided that rate schedules approved by the Commission shall be *prima facie* reasonable "until finally found otherwise in an action brought for that purpose"—implying a right of appeal to the courts not limited to the utility company.

Assuming then that the words "any person affected by" a rate order might be considered as referring to consumers, the question naturally arises whether there is any significance in the fact that Congress did not use the words "any consumer" or "any rate payer." To put the question somewhat differently: Is there reason to believe that the words "any person affected" were used in a restrictive sense so as to differentiate between rate payers who were "affected" and rate payers who were not "affected"?

The answer lies in the fact that the appeal provisions are general in their scope—that is, they grant a right of appeal from *any* order of the Commission—and the variety of the orders is such that the words "consumer" or "rate payer" would not be appropriate in all cases, and therefore words of general applicability had to be used. For example, orders under paragraph 3 (Code, sec. 43-302), directing or refusing to direct the joint use of facilities of two utilities following an application by "any interested person" that such joint use be determined to be in the public interest; orders under paragraph 38 (Code, secs. 43-308) entered upon public complaint as to trolley-car or water service; order under paragraph 41 (Code, sec. 43-411) determining whether and on what terms requested extensions of lines or service shall be made; orders under paragraph 59 (Code, sec. 43-605) removing meter inspectors from office. We think it quite clear that Congress used words of broad applicability because it was phrasing a section which related to all the orders which the Commission might issue and because it wanted to make clear that all the people upon whom an order impinged should have a right to question it.

The words "affected by any final order or decision" are obviously words of extremely broad meaning. "Affected" means "to act upon, to produce an effect on" (Webster's New International Dictionary); "to concern, to effect a change on"

(Fowler, Dictionary of Modern English Usage). The word "affected" is broader than the word "injured," which has been held to require a showing of "legal damage" in order to have standing as a party plaintiff in a separate "case or controversy" cognizable by a constitutional court. *Alabama Power Co. v. Ickes*, 302 U. S. 464, 483, 484. The word is broader than the word "aggrieved," which gives the party standing on appeal though he may show only financial injury rather than legal damage. *F. C. C. v. Sanders Radio Station*, 309 U. S. 470, 477. When it comes to a rate order it is obvious that consumers are affected whether the rates are raised, or are retained at existing levels in the face of a contention that they should be reduced, or are lowered to an extent believed insufficient. The provisions of the act for public notice, and for participation informally or as intervening parties, clearly reflect a Congressional view that consumers are "interested" and are "affected" and are the group who, in a rate case, are to have the right to carry their position to the courts. Cf. paragraph 63 (Code, sec. 43-703).

We do not believe it can be seriously suggested that the Congress intended that the United States should not be regarded as a "person or corporation" within the meaning of the appeal provisions, in the sense that while a private person or corporation may avail himself or itself of the remedy the United States cannot. The words "person or corporation" are commonly used in place of, and with precisely the same meaning as, the excessively prolix wording in which lawyers sometimes indulge out of an excess of precaution. It is apparent that Congress in drafting the Utility Law did not attach great importance to either precision or consistency in this particular matter. In paragraph 3 (Code, sec. 43-302), for example, it uses the words "any person, firm, copartnership, association or corporation interested" which is obviously unnecessary since in paragraph 1 (Code, sec. 43-101) it defined "person" to include "an individual and a firm or copartnership," and "corporation" to include "a corporation, company, association, and joint-stock company or association." The recognition of the United States as a person or corporation for the protection of

its interests is imbedded in our law. The Supreme Court said in *Cotton v. United States*, 11 Howard 229, 231:

Every sovereign State is of necessity a body politic, or artificial person, and as such capable of making contracts and holding property * * * It would present a strange anomaly, indeed, if, having the power to make contracts and hold property as other persons, natural or artificial, they were not entitled to the same remedies for their protection.

See also *Helvering v. Stockholms Enskilda Bank*, 293 U. S. 84, 92. While it lies within the power of Congress to deny remedies to the United States, it should require the clearest and most direct language to exclude it. See *United States v. Cooper Corporation*, 312 U. S. 600, 607-614.

There remains the question whether the language of paragraph 91A of the Utility Law (Code, sec. 43-205), p. 10, *supra*, creating the office of People's Counsel, should be so construed as to vest exclusively in him the right to prosecute consumer appeals from rate orders. The language is that he "Shall represent and appear for the people of the District of Columbia at all hearings of the commission and in all judicial proceedings involving the interests of users of the products of or service furnished by public utilities under the jurisdiction of the commission * * * [and] * * * shall represent and appear for petitioners appearing before the commission for the purpose of complaining in matters of rates and services."

These words are obviously susceptible of a construction which limits them to a definition of the duties of People's Counsel. They are entirely lacking in words of exclusivity. It is assumed that the Court will seek to interpret the statute so as to remove conflicts between apparently inconsistent sections. This can be done by construing paragraph 91A merely as a definition of the duties of People's Counsel, not in derogation of the right of persons affected who see fit to themselves prosecute matters before the Commission or in the courts for their own protection.

In authorizing and requiring People's Counsel to appear "for the people of the District of Columbia," Congress recognized

that the people have a collective interest. In providing that "any person or corporation affected" may apply for reconsideration or may appeal, Congress recognized that consumers have individual interests. There is nothing to suggest that these interests are merged in People's Counsel. Congress could not fail to recognize that these interests may be in conflict with each other. For example, suppose that the United States claimed, as it might well have in this case, that in view of the greater amount of electric energy purchased by it as compared with that of the Capital Transit Company, and in view of the fact that it pays a greater charge per kilowatt hour than the Transit Company, the rates are discriminatory against the United States. In whose behalf would People's Counsel then appear? Could he, appearing in behalf of the "people" represent the interests of both the United States and the Capital Transit Company? In a case of this character a construction of the statutes which would result in a holding that a consumer has no appealable interest separate from People's Counsel would reduce the statute to an absurdity.*

PEPCO's position is that no consumer may have relief from rates, no matter how unjust or unreasonable, if People's Counsel does not deem it desirable to appear on behalf of the people or if he decides to appear on behalf of the utility's interest. The absurdity of this contention appears in bold relief in this very case. Here the United States is appealing from a rate order on the ground that the return allowed to the utility results in rates which are unjust and unreasonably excessive. PEPCO filed an answer in support of its interest, which is adverse to that of the United States. The Commission filed an answer in support of its order—an interest adverse to the United States. People's Counsel, who presumably must act, if at all, on behalf of the "people of the District of Columbia," did not align himself with the consumer interest represented by our appeal, but with the Commission, his answer being identical with that of the Commission. But the "people" have

* A statute should not be construed in a manner leading to an absurd result. *Huidekoper v. Douglass*, 3 Cranch 1, 72; *United States v. Katz*, 271 U. S. 354, 362.

no interest adverse to the appeal of the United States. Had the United States claimed that it was entitled to a reduction in rates at the expense of the other rate payers, People's Counsel could conceivably appear to protect the interest of the "people." But the United States is not claiming a rate advantage over the other consumers. It is not even claiming that it is entitled to a rate reduction which would leave the other rate payers with their present rates. The United States, as a consumer, is seeking to establish that all consumers are entitled to a greater reduction than was ordered by the Commission. In such circumstances, it cannot be said that People's Counsel is appearing in opposition to an interest adverse to the people of the District of Columbia, and the fact that he is unwilling to present the contentions of the United States should not preclude their presentation.

The right to appear by counsel of one's own choosing is a fundamental right. To hold that People's Counsel must represent the interest of the consumer to the exclusion of his own counsel is in derogation of the consumer's right. Such an interpretation should be avoided, unless required by the wording of the statute; which obviously is not the situation here.

It must be assumed that Congress was aware of the fact that the Federal Government is a large consumer of electric energy. In view of this fact, the argument against the position taken by PEPCO, which would exclude the United States from itself protecting its interests as a rate payer, is particularly compelling. By long established provisions of law the Attorney General may, "whenever he deems it for the interest of the United States, either in person conduct and argue any case in any court of the United States in which the United States is interested" or may assign that task to others.⁵ Until 1906, the task of conducting proceedings in the various District courts devolved upon the United States District Attorneys. In that year, however, Congress passed an Act⁶ authorizing the Attorney General, or any attorney acting under his direction, to conduct any legal proceeding which the District Attorneys

⁵ R. S. 359, 5 U. S. C. 309.

⁶ Act of June 30, 1906, c. 3935, 34 Stat. 816, 5 U. S. C. 310.

might be by law authorized to conduct. These legal proceedings included "all civil actions in which the United States shall be concerned."⁷ Questions have arisen whether persons, other than the Attorney General or those acting under his direction, may appear on behalf of the United States or on behalf of officers of the United States when acting in their official capacity.⁸ Questions have arisen whether the Attorney General may exclude others from representing the United States. But never, until this case, has it been suggested that some other attorney or counsel may exclude the Attorney General, or an attorney acting under his direction, from appearing on behalf of the United States in a case in which the United States is interested. Paragraph 91A, as applied by the court below, would operate as a *pro tanto* repeal of the right of the Attorney General to represent the United States. Repeals of statutes will not be supplied by implication unless there is a clear inconsistency between the later and the earlier acts. *West India Oil Co. v. Domeneck*, 311 U. S. 20, 29. A repeal of a statute by implication is never admitted where the two acts can be reconciled. There is no difficulty in reconciling the right of People's Counsel to appeal on behalf of the people of the District of Columbia and the right of the Attorney General to appeal on behalf of the United States. It is true that the United States is appearing as a consumer; but it is, nevertheless, the United States and is entitled to be represented by counsel of its own choosing, especially when such counsel is designated by law.

As a final argument against construing paragraph 91A (Code, sec. 43-205) as vesting in People's Counsel an exclusive right to represent consumers in the District Court, it is pointed out that the same construction leads inevitably to the denial to consumers of a right to appear even before the Commission. The section not only provides that People's Counsel shall represent the people "in all judicial proceedings" but also that he shall represent them "at all hearings of the Commission." Such a result would conflict with the rights given to consumers by other sections to make complaints, summon witnesses, take de-

⁷ Act of Sept. 24, 1789, c. 20, sec. 25, 1 Stat. 92.

⁸ *Sutherland v. International Ins. Co. of New York*, 43 F. (2d) 969.

positions and attend hearings, and with the rules and long settled administrative practice of the Commission which permit consumers to participate informally or upon intervention. In the present case it would have meant that if the United States desired to have its contentions presented the hearings would have had to be postponed, since the office of People's Counsel was vacant throughout all the hearings which resulted in the rate order here under attack.

II

The legislative history clearly shows a Congressional intent that consumers shall have standing to prosecute an appeal. The administrative practice of the Commission is to the same effect

The office of People's Counsel was created by amendment in 1926,⁹ (Par. 91A of Utility Law; Code, sec. 43-205). At that time the appeal provisions gave a right to "any public utility or any person or corporation interested" to file a suit in equity in the District Court to set aside or enjoin the order. Only ineptitude or carelessness can account for the failure of the amendment to delete the italicized words and substitute "People's Counsel" therefor, if it had been the purpose of Congress—as contended by PEPCO—to limit the right of appeal to the utility and to People's Counsel. In 1935 the remedy of a bill in equity was changed to the present method (Utility Law, par. 64, 65; Code, secs. 43-704, 43-705) of a petition of appeal to the District Court,¹⁰ but substantially the same description of the class entitled to appeal was retained. It is quite unreasonable to ask this Court to assume that Congress twice overlooked the inconsistency which so obviously would exist between its appeal provision and paragraph 91A if the latter vested in People's Counsel an exclusive right to appeal on behalf of consumer interests.

When the 1935 bill was introduced, the Corporation Counsel who had drafted the new sections stated:

⁹ Act of Dec. 15, 1926; 44 Stat. 921.

¹⁰ Act of Aug. 27, 1935; 49 Stat. 882, c. 742, sec. 2.

In the first section of the bill, we require that after an order of the Commission, *anybody interested* may make an application for reconsideration and then that no appeal shall lie unless an application for reconsideration has been made.¹¹ [Italics supplied.]

Counsel for the telephone company criticized the breadth of the provision in the following language:

Under the public utility law here any ratepayer is affected. A man that has never been in this litigation before * * * could walk in after this Commission has decided and entered an order, and file an application under this law for rehearing or reconsideration, because he is a party at interest * * *.¹²

The legislative history of paragraph 91A does not support the view that People's Counsel should have the exclusive right of appeal from the Commission's orders. Paragraph 91A was introduced as part of a bill (H. R. 11119) "to alter the personnel of the Public Utilities Commission of the District of Columbia." In reporting this bill on the floor of the Senate, Senator Capper stated:¹³

The second object of the bill is to define and enlarge the duties of the lawyer for the Public Utilities Commission provided in the District of Columbia appropriation act of May 10, 1926, so that he will act as "people's counsel" at all hearings of the Commission and in all judicial proceedings involving the interests of the patrons of the public utilities in the District of Columbia. He is specifically charged with the duty of representing and appearing for petitioners before the Commission in matters of rates or service. * * *

Nothing in what Senator Capper said can possibly be interpreted to mean that by appearing before the Commission or in the courts, People's Counsel may preclude consumers from having their own counsel. According to Senator Capper,

¹¹ Hearings before the subcommittee on Public Utilities of the Committee on the District of Columbia, 74th Congress, 1st Sess., on H. R. 3462, p. 2.

¹² Ibid., p. 7.

¹³ Senate Report No. 1024, 69th Congress, 1st Session, p. 2.

it is the *duty* of People's Counsel to appear *for* petitioners before the Commission. It is well known that individual consumers usually have a stake too small to warrant engaging in the long-drawn-out litigation which is a regular tactic of utility companies. Obviously People's Counsel may not appear for the utilities or against the petitioners, as he is doing in this case. He may not even refuse to represent petitioners, except perhaps upon honest belief that their claims are without merit. But in such instances, he would be going far afield to deny to a petitioner the right to have counsel of his own.

There were no debates which would throw further light on the question, but in the hearings before the Senate Committee, the entire reason for a People's Counsel was disclosed. It appeared that in 1924 in the settlement of certain litigation involving PEPCO's rates, the consumers got only \$3,000,000 out of an impounded fund of \$6,000,000,¹⁴ and it was felt by those who urged the establishment of this office that if the Commission had counsel representing the people of the District of Columbia, he could have gone into the matter and could have maintained the position of the people that they were entitled to much more than they got. They felt that the Corporation Counsel and his assistants were too busy with other matters, and that there was no counsel who could develop the evidence necessary for the valuation cases. The Chairman of the Public Utilities Committee of the Federation of Citizens' Associations was under the impression that the Federation could not bring a cross-action to claim a valuation lower than that determined by the Commission, because the Federation was not an incorporated body.¹⁵ The Chairman of the Commission himself felt that most of all the Commission needed "more legal service."¹⁶

From these hearings it is apparent that the Congressional purpose was to provide an attorney who, in proceedings before the Commission or in the courts, would take a position adverse

¹⁴ Hearings before the Committee on the District of Columbia, U. S. Senate, 69th Congress, 1st Session, H. R. 11119, p. 10.

¹⁵ Hearings before the Committee on the District of Columbia, U. S. Senate, 69th Congress, 1st Session, H. R. 11119, p. 13.

¹⁶ *Ibid.*, p. 17.

to the utility. It was intended that the people should not be without some representation. There is no suggestion that in taking a position adverse to the utility People's Counsel could exclude anyone else from maintaining such a position. It certainly was not contemplated that People's Counsel might align himself with the utility, and that then a consumer substantially affected could not have his day in court because he could not be represented otherwise than by People's Counsel.

The interpretation of the statute which we are contending for is consistent with the administrative practice which has been followed by the Commission itself. Rule 7.1 of the Commission's "Rules of Practice and Procedure" provides for intervention as a formal "party" by anyone found by the Commission to have a "substantial interest." Rule 14.1 provides that "any person affected by any final order or decision may file an application for reconsideration." Rule 1.1 defines "person" as "an individual copartnership, association, corporation, body politic, municipal organization, governmental body, joint stock company, receiver, trustee or official acting in his official capacity." The Commission did not limit the right to file an application for reconsideration to People's Counsel or to those who were parties to the proceeding, nor to those who might be legally damaged by the order or decision. The rule was made broad enough to embrace any consumer who is "affected," as a matter of fact. The interpretation of the statute now used by PEPCO would, therefore, be not only contrary to the language of the statute, but also to the legislative intent and to administrative treatment.

III

The decisions support a construction of the code giving the United States standing to appeal

The United States acquired status as a "party" upon the allowance by the Commission of its petition for leave to intervene; and as a party litigant under this statute it has a right to follow its case to final judgment. Cf. *I. C. C. v. Oregon-Washington RR. and Navigation Co.*, 288 U. S. 14, 26; *State of Texas v. Anderson, Clayton & Co.*, 92 F. (2d) 104; *S. E. C.*

v. *U. S. Realty & Improvement Co.*, 310 U. S. 434, 460. The allowance of the petition to intervene required a finding, under the "Rules of Practice and Procedure" of the Commission, that the United States has an interest. See Rules 1.2 and 7.1 at page 11, *supra*.

In *The Chicago Junction Case*, 264 U. S. 258, the court recognized the significance of the allowance of intervention before a commission in accordance with its rules of procedure. On pages 267 and 268, the court says:

The plaintiffs may challenge the order because they are parties to it. The Judicial Code, Section 212 * * * declares that any party to a proceeding before the Commission may as of right become a party to "any suit wherein is involved the validity of such order" * * * . The fact of intervention, allowed as it was, implies a finding by the Commission that the plaintiffs have an interest. In proceedings before the Commission they opposed by evidence and argument the granting of the application. This they did as of right. For under the rules of practice, adopted by the Commission pursuant to Paragraph 1, Section 17, of the Interstate Commerce Commission Act, the intervener becomes a party to the proceedings, entitled, like any other party, to appear at the taking of testimony, to produce and cross-examine witnesses, and to be heard in person and by counsel. The intervention must be preceded by an order of the Commission granting leave; and leave can be granted only to one showing interest.

Similarly in *Associated Industries v. Ickes*, 134 F. (2d) 694 (C. C. A. 2), cert. granted 319 U. S. 739; remanded for further hearing without decision of the issues 320 U. S. 707, the court says at p. 709, "The Commission, by allowing petitioner to become a party, must be deemed to have found that petitioner came within the class of 'interested Parties.' "

Section 43-705 of the Code is similar to other recent statutes in which Congress has permitted "*aggrieved persons*" or "*interested parties*" in proceedings before administrative commissions to prosecute or participate in appeals to designated courts.

See: 26 U. S. C. 45 (a), Interstate Commerce Commission; 47 U. S. C. 402 (b) (2), Federal Communications Commission; 15 U. S. C. 836 (b), National Bituminous Coal Commission.

The validity of such statutes is established in *Nashville Grain Exchange v. United States*, 191 Fed. 37 (Comm. Ct.); *City of Atlanta v. United States*, 308 U. S. 517; *Federal Communications Commission v. Sanders Radio Station*, 309 U. S. 470; *Associated Industries v. Ickes*, *supra*; *National Broadcasting Co. v. F. C. C.*, 132 F. (2d) 545, 547, *aff'd*, 319 U. S. 239; *Yankee Network, Inc. v. F. C. C.*, 71 App. D. C. 11, 107 F. (2d) 212; *I. C. C. v. Oregon-Washington RR Co.*, 288 U. S. 14, 25-26; *Scripps-Howard Radio v. F. C. C.*, 316 U. S. 4; and *F. C. C. v. National Broadcasting Co., Inc.*, 319 U. S. 239.

These cases do not depart from the principle that in the absence of an invasion of a substantive legally protected interest of the plaintiff there is no such judicable controversy as will warrant a separate suit (see *City of Atlanta v. United States*, *supra*, and the discussion in *Associated Industries v. Ickes*, *supra*, at pages 700-705). They decide that Congress may properly give to persons falling within the class of "interested parties" or "aggrieved persons" authority to participate in appellate proceedings in support of the public interest in attacking or upholding the orders of the Commission. The distinction is between parties seeking to vindicate their own rights and those persons who may qualify under a permissive statute to speak in behalf of the public interest. In *F. C. C. v. National Broadcasting Co.*, 319 U. S. 239, at page 247, the court says in commenting on the *Sanders Brothers case*, *supra*, "we pointed out that while a station license is not a property right, and while the Commission was not bound to give controlling weight to economic injury to an existing station consequent upon the issuance of a license to another station, yet economic injury gave the existing station standing to present questions of public interest and convenience by appeal from the order of the Commission."

The United States clearly falls within the class of "interested parties" or "persons or parties affected" as those words, or similar words, have been construed. In *Hollis v. Kutz*, 255 U. S. 452, decided when the Utility Law of the District of Columbia

gave a right of appeal to "any party interested and dissatisfied with any order," the court held that customers of the Washington Gas Company were "persons interested," and entitled to resort to the court. In the *Sanders, Yankee Network, Scripps-Howard*, and *N. B. C.* cases, *supra*, competing broadcasting stations whose business would be affected by the commission's order were held to fall within the class of "any * * * person aggrieved or whose interests are adversely affected by" the decision and therefore entitled to prosecute or participate in an appeal. In *I. C. C. v. Oregon-Washington R. R. Co.*, *supra*, persons affected by the lack of adequate railroad service in their communities were held to be "parties in interest" and "aggrieved parties." In *The Chicago Junction Case*, *supra*, railroads which would suffer financial loss by control of terminal facilities by a competitor were held to be interested in the controversy "and therefore entitled to participate in the appeal." In *Associated Industries v. Ickes*, *supra*, coal consumers who would be affected by minimum prices fixed by the National Bituminous Coal Commission were held to be "persons aggrieved" by the Commission's order. In the *Sanders* case, in holding that the intervener had a right to participate in the court proceedings, the court said at page 477: "Congress had some purpose in enacting Section 402 (b) (2). It may have been of the opinion that one likely to be financially injured by the issue of a license would be the only person having a sufficient interest to bring to the attention of the Appellate Court errors of law in the action of the Commission in granting the license. It is within the power of Congress to confer such standing to prosecute an appeal." In the *Associated Industries* case, *supra*, it was pointed out that persons subjected to a suppression of competition (as is true in case of public utility monopolies) have—in contrast to those whose economic loss will result from enlarging competition, as in many of the broadcasting cases—a special interest to vindicate the public position.

The contention that "Consumer's Counsel" (under a statute similar to that creating People's Counsel in our case) has the right to exclusive representation of consumer interests was rejected in the *Associated Industries* case, *supra*. At page 708, the Court says:

* * * they advance an awkward argument for shutting out of court every actual consumer (and all representatives selected by actual consumers) and for confining efforts to obtain court relief for consumers to such activities as the official Consumer's Counsel, in his sole and unregulated discretion, may choose to undertake. For respondent's argument includes an admission—more, a contention—that it is merely the representation by Consumer's Counsel of the consumer's interests which, by implication, makes him "a person aggrieved." Consequently, if the Act does not constitute him the exclusive consumers' representative, respondent's own argument leaves no escape from the conclusion that anyone possessing or representing a consumer's interest is a "person aggrieved"; and accordingly, if he was a party to the Commission proceedings, entitled to seek court review * * *. The Commission, by allowing petitioner to become a party, must be deemed to have found that petitioner came within the class of "interested parties."

To deprive consumers of representation except through the Public Utilities Commission and People's Counsel conflicts with the purpose of Section 43-705 to safeguard consumer interest by conferring status upon parties affected.

Cases like *New York City v. New York Telephone Co.*, 261 U. S. 312 are entirely inapposite; (1) the statute there involved specifically provided for exclusive representation of the public interest by the Attorney General and the Public Service Commission, (2) the City of New York, as petitioner for intervention, had only an indirect interest because it was not itself paying the rates in question but received the benefit of a special contractual rate. In *City of New York v. Consolidated Gas Co.*, 253 U. S. 219, where the facts were similar, the court held intervention was discretionary. In *re Englehardt & Sons*, 231 U. S. 646, the petitioner was granted intervention on its own behalf. The complaint was that it was not permitted to intervene on behalf of all other subscribers.

Alexander Sprunt & Son v. United States, 281 U. S. 249, and *Pittsburgh & W. Va. Ry. v. United States*, 281 U. S. 479, are inapplicable and do not support the position for which they

are cited by PEPCO. The former held that a shipper's right to a continuance of a competitive advantage might be asserted by intervention but that the shipper could not maintain an independent suit without an independent right. The latter denied the right of a connecting carrier unaffected by the order to institute an independent suit to set aside an order of the Interstate Commerce Commission relating to terminal facilities in Cleveland.

Finally, it is suggested that the Court should reject PEPCO's construction, which would permit a utility to appeal from too low rates but deny consumers standing to appeal from too high rates, by an application of the salutary rules that interpretations should be avoided which may give rise to constitutional doubts¹⁷ or are in derogation of established rights.

¹⁷ *Harriman v. I. C. C.*, 211 U. S. 407, 422. The express language of the applicable statutory provisions and the legislative history of the proceedings that led to the inclusion of these provisions in the statute so clearly support the construction of the statute here contended for by the appellant that this court has no occasion in this case to consider whether or not any statute seeking to deprive consumers of judicial review of the rate-making activities of an administrative tribunal would be subject to any constitutional infirmity. It may be noted, however, that the United States Supreme Court has recognized that the substantive right of the public in adequate transportation and other public utility services is not without any protection under the constitution. See *Chicago, Milwaukee & St. Paul R. R. v. Minnesota*, 134 U. S. 418, 458, 459, where the court said:

"The question of the reasonableness of a rate of charge for transportation by a railroad company, involving as it does the element of reasonableness both as regards the company and as regards the public, is eminently a question for judicial interpretation, requiring the due process of law for its determination."

* * * * *

"Neither the legislature nor such commission acting under the authority of the legislature, can establish arbitrarily and without regard to justice and right a tariff of rates for such transportation, which is so unreasonable as to practically destroy the value of property of persons engaged in the carrying business on the one hand, nor so exorbitant and extravagant as to be in utter disregard of the rights of the public for the use of such transportation on the other.

"In either of these classes there is an ultimate remedy by the parties aggrieved, in the courts, for relief against such oppressive legislation, and especially in the courts of the United States, where the tariff rates established either by the legislature or by the Commission are such as to deprive a party of his property without due process of law."

At common law users of the services of public utilities had a right to appeal to the courts for protection against or relief from excessive charges.¹⁸ We believe that paragraphs 2, 63 and 65 (Code, secs. 43-301, 43-703 and 43-705), providing that unjust and unreasonable rates are unlawful and that rates fixed by the Commission are valid only until found otherwise by the courts and that parties affected may appeal, are a codification of this principle as applicable to situations where rates are fixed in the first instance by an administrative body rather than by a court. We suggest that it would require vastly more precise language than occurs in the District of Columbia Utility Law to support a conclusion that Congress intended to curtail the public's common law rights. The provision for administrative findings of fact followed by an appeal on questions of law can be regarded as a reasonable equivalent of the judicial remedy at common law if constructed to permit consumer appeals; and it should therefore be so constructed.

See also H. W. Edgerton: "Value of the Service as a Factor in Rate Making," 32 Harvard L. Rev. 516, 534, n. 63; and *Southern Indiana R. R. Co. v. R. R. Commission*, 172 Ind. 113; 87 N. E. 966, 971.

IV

Discussion of order to be entered on denial of motion to dismiss. This Court should retain the case and decide it on the merits

The question we wish to discuss now is whether upon a denial of the motion to dismiss the case is to be remanded to the District Court for hearing or is to be retained and disposed of here on the merits. We believe that it should be retained and decided here on the merits.

The arguments in favor of retention and decision on the merits will be different, if it be considered that the District Court decided only that the United States as a consumer has no standing to appeal, from what they will be if the court's order be also construed as a decision that the petition of appeal was demurrable—which we understand to be the in-

¹⁸ *I. C. C. v. Baltimore & Ohio R. R. Co.*, 145 U. S. 263, 275.

terpretation placed on the order by PEPCO and the Commission. On the first of these interpretations of the order, the issue involved in the pending motion would be co-extensive with the appeal itself; and retention would have to rest on a desire to avoid considering part of the merits on PEPCO's appeal and part when our case gets back here again on a second appeal from the District Court. If the alternative interpretation be adopted, the denial of the pending motion would leave for decision the correctness of the other part of the District Court's decision, and there would then arise a need for some discussion as to whether this court should deal with the case as though upon a demurrer to our petition of appeal or upon the entire record before the Commission.

The doubts as to what the District Court did arise from the ambiguity of the third ground assigned for dismissal, i. e., "The petition fails to state any facts—(3) entitling the petitioner to relief herein." The answers of the Commission and of People's Counsel each set up as a first defense that, "The petition of appeal fails to state a claim against the respondents upon which relief can be granted." The 14th paragraph of PEPCO's answer alleged that "said petition of appeal herein fails to set forth any facts entitling petitioner to relief." All three answers conclude with a prayer for dismissal of the petition. Counsel for PEPCO argued not only the question as to the standing of the United States to appeal but also that there should be dismissal because the petition did not state a cause of action. Counsel for the Commission concluded his argument against the sufficiency of the petition with the statement, "They have failed to state any cause for which relief can be granted." People's Counsel's position was that "This appeal fails to allege any facts which if true would entitle them to the relief for which they pray." In the face of such pleadings and arguments the third ground for dismissal could certainly be construed as a ruling as though upon a demurrer. On the other hand, if emphasis is given to the word "Petitioner", it may mean no more than that there is nothing in the petition curing the lack of standing arising from the matters referred to in the first two sub-paragraphs of the order.

We believe that this court should retain the case and decide it on the merits regardless of the construction given to the District Court order. By the provisions of Par. 65 (Code 43-705) the petition of appeal "shall be heard upon the record before the Commission" (certified to the court under an earlier provision of the same paragraph); and the District Court may not receive any further evidence. Par. 66 (Code 43-706) limits the determination of the District Court to questions of law, and provides that the "findings of fact by the Commission shall be conclusive unless it shall appear that such findings are unreasonable, arbitrary or capricious." Our petition of appeal does not attack the Commission's findings of fact. It contains no allegation outside the certified record. It raises only questions of law. It follows that whether the order of the District Court dealt with the motion to dismiss as the equivalent of a demurrer, and whether this was or was not error in view of its duty to decide the case on the record rather than on the pleadings, and whether the case is sent back for decision of the law questions and comes again to this court on appeal, this court will in any of these events be in no different position to deal with the law questions than it is in at the present time. If, on the other hand, the District Court order be construed as dealing only with the standing of the United States to appeal and the case is remanded for consideration on demurrer or on the record (as this court may direct), the case will come back here again for decision of the same legal questions, which must sooner or later be decided here. We respectfully suggest therefore that this court decide the legal questions raised by our appeal upon a consolidated hearing with Pepco's appeal, thereby saving the time of the courts and minimizing the delay in reaching a conclusion of the litigation. Congress evidently had in mind the undesirability of delay in rate cases when it provided in Par. 65 (Code 43-705) that such cases "shall have precedence over any civil cause of a different nature." Attention is called to the fact that under the sliding-scale arrangement the annual adjustment of rates is predicated on the experience of the preceding year, and that the 1945 rate proceedings are now held up pending the decision of this case, and that fixing the 1946

rates will be similarly delayed if this case has to go back to the District Court at this season of the year.

V

CONCLUSION

For the foregoing reasons, it is submitted that the motion to dismiss the appeal should be denied.

Respectfully submitted.

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